[2020] UKUT 0245 (TCC)

Appeal number: UT/2019/0163 (V)

INCOME TAX – profits of a jewellery and bullion trader – appeals by taxpayer and by HMRC – presumption of continuity – taxpayer's appeal allowed and HMRC's appeal dismissed

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

STIRLING JEWELLERS (DUDLEY) LIMITED	**Appellant/Respondent**
-and-	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents/Appellants**

TRIBUNAL: **JUDGE TIM HERRINGTON**
JUDGE JONATHAN RICHARDS

Sitting in public by way of remote video hearing treated as taking place at The Royal Courts of Justice, Strand, London on 15 and 16 July 2020

Thomas Chacko, instructed by CWP Accountants, for Stirling Jewellers (Dudley) Limited

Sadiya Choudhury, instructed by the General Counsel and Solicitor for Her Majesty's Revenue & Customs, for the Commissioners

DECISION

Introduction

1. These are appeals by both Stirling Jewellers (Dudley) Limited ("Stirling") and HMRC against a decision (the "Decision") of the First-tier Tribunal (Tax Chamber) (the "FTT") released on 22 January 2019.

2. At material times, Stirling carried on a trade as a jeweller and bullion dealer. It appealed to the FTT against discovery assessments and closure notices that HMRC made in respect of its accounting periods ended 31 January 2007 to, and including, its accounting period ended 31 January 2014.

3. Between 2007 and 2012, the price of gold rose substantially. This resulted in a transformation in Stirling's business. In its 2006 accounting period, it had a turnover of around £3m and focused on selling jewellery to the public and to other shops. However, by APE 2011[1], it had a turnover of over £140 million and its business consisted almost entirely of purchasing scrap gold for smelting. Stirling accepts that its record-keeping processes did not cope well with the increase in the scale of its business, although the extent of its failures in this respect is the subject of some dispute. HMRC issued their assessments and closure notices because they did not consider that Stirling had provided sufficient evidence of expenditure that Stirling claimed to have incurred on the purchase of gold. To give an indication of the scale of the issue, in APE 2011, there was a difference of £9,078,689 between the amount that Stirling claimed to have spent on purchases of gold and the amount that HMRC considered could be established by reference to Stirling's business records.

4. HMRC's assessments and closure notices relied on two distinct, but related propositions. First, HMRC increased Stirling's profits chargeable to corporation tax on the basis that they did not consider that Stirling could prove it had spent as much on purchases of gold as it claimed to have spent. Second, HMRC assumed that the additional profits so generated were the subject of loans to a participator in Stirling (which was a "close company" for tax purposes) so as to result in charges to tax under s419 of the Income and Corporation Taxes Act 1988 ("ICTA") and s455 of the Corporation Tax Act 2010 ("CTA 2010").

5. Thus, at the heart of all of HMRC's assessments and closure notices was the proposition that a proportion of Stirling's expenses should be "added back" in its corporation tax calculation so as to result in both (i) additional taxable profit and (ii) charges to tax under s419 of ICTA/s455 of CTA 2010. HMRC performed a detailed calculation of the amount of the expenses that they considered should be added back in relation to Stirling's APE 2011. They then applied the "presumption of continuity" to justify a similar proportion of add-back in other relevant accounting periods, although they followed a slightly different methodology in respect of APE 2009.

[1] i.e. Stirling's accounting period ended 31 January 2011. We will adopt a similar format when describing other accounting periods.

6. The FTT made the following determinations in the Decision:

> (1) For APE 2011, some expenditure had to be added back to Stirling's corporation tax calculation, though the amount of the add-back was less than HMRC had asserted in their closure notice for this accounting period.
>
> (2) Applying the "presumption of continuity", it decided that some expenditure had to be added back in the determination of Stirling's taxable profit in APE 2010. That amount was to be calculated by reference to the FTT's determination of the proportion of expenditure that fell to be added back in APE 2011. Therefore, the amount of add-back in APE 2010 was also lower than the amount for which HMRC had argued.
>
> (3) Stirling was not liable for any tax under s419 of ICTA 1988/s455 of CTA 2010 in respect of any accounting period under appeal.
>
> (4) The FTT declined to apply the "presumption of continuity" in any accounting period other than APE 2010. It followed that Stirling's appeals against HMRC's closure notices and assessments for APEs 2007, 2008, 2009, 2012, 2013 and 2014 were allowed in their entirety.

7. With the permission of the Upper Tribunal, both Stirling and HMRC appeal against the Decision:

> (1) Stirling argues, in essence, that the add-back that the FTT made in respect of APE 2011 was too high. It does not challenge the FTT's decision to apply the "presumption of continuity" and add back expenses in APE 2010. However it asserts that the add-back in APE 2010 was excessive for the same reason as that for APE 2011 was excessive.
>
> (2) HMRC challenge the FTT's refusal to apply the presumption of continuity to APEs 2007, 2008 and 2009. They do not appeal against the FTT's determination that no tax was due under s419 of ICTA/s455 of CTA 2010. They also do not appeal against the FTT's refusal to apply the presumption of continuity in APEs 2012, 2013 and 2014.

The decision under appeal

8. The parties' challenges to the Decision are reasonably self-contained and focused. Moreover most of the FTT's findings of primary fact are not under appeal and instead both Stirling's and HMRC's appeals challenge the FTT's findings of secondary fact, most notably the FTT's conclusions as to the amount of profit that Stirling made in relevant accounting periods.

9. We will not, therefore, summarise all aspects of the Decision. Rather, we will focus our summary on the parts of the Decision that are under appeal. In the remainder of this decision, unless we specify otherwise, numbers in square brackets are references to paragraphs of the Decision.

Findings of fact as to Stirling's conduct of its business

10. The bulk of Stirling's purchases of gold in the accounting periods in dispute were made from trade sellers[2], who had themselves bought from members of the public. These trade sellers typically paid their own customers in cash and therefore expected and required Stirling to pay them in cash. As Stirling's turnover multiplied, obtaining the requisite cash was one of its biggest concerns and Mr Ragonesi, one of Stirling's two directors and a 50% shareholder in Stirling together with his wife, would spend a good proportion of most working days withdrawing cash from Stirling's bank accounts ([116] to [119]). Stirling would frequently be unable to pay a particular customer cash in full and in such cases would make a partial cash payment and issue a hand-written IOU for the balance ([139]).

11. People wishing to sell gold to Stirling would typically bring their gold to Stirling's shop in Birmingham ([126]). In most cases Stirling would base the price that it paid for the gold on three factors:

(1) The "spot price" for fine gold that was fixed and published twice daily;

(2) The weight of the gold.

(3) The purity of the gold which Stirling sought to ascertain with an expensive specialist piece of equipment referred to as a "gold gun".

12. The FTT concluded, at [108] that:

> 108. The Appellant aimed to pay its sellers, but did not always pay, the equivalent of 97.5% of the spot price. However, the Appellant did adjust the price paid - albeit on an unknown (and now, unknowable) number of occasions - to take account of the identity of its customer. Whilst many of its sellers got 97.5% of the spot price, some of its bigger customers sometimes got up to 1%, or even 1.5%, more. Thus, the Appellant's margin was 2% at most: but sometimes, especially for larger sellers, significantly less.

13. Stirling sold most of the gold that it purchased, with the exception of gold coins discussed further below, to a smelter (Englehard). The Decision is not entirely clear as to the price that Englehard would pay Stirling. At [112] it said:

> 112. The smelter would pay the Appellant 99.5% of the spot price. But the smelter did not simply accept everything which the Appellant sent to it, as and when it was sent. The smelter itself, buying at 99.5% of fix (i.e. a margin of 0.5% at most) was operating a different business model to the Appellant.

However, at [260(5)] and [260(6)], when highlighting what it saw as difficulties associated with a "gold reconciliation exercise" that would have involved deducing Stirling's profits from the gross sums paid by Englehard, the FTT suggested that Englehard may not always have paid precisely 99.5% saying:

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[2] Like the FTT and the parties before us, we refer to these as Stirling's "customers" even though they were selling to Stirling, rather than purchasing from it.

> (5) Some sales to the smelter were not at 99.5%, but (according to Mr Ragonesi, 'in the earlier days', but he could not say when those ended) were at 99.75%;
>
> (6) The smelter often paid *'around 97%*' of what the gold should be worth, with a subsequent payment of *around* 2.5% when the gold was fully weighed and assayed;

14. We do not agree with Stirling that, at [112], the FTT was making a finding that in APE 2011 Englehard always paid 99.5% of the gold fix. That would be inconsistent with the uncertainty to which the FTT was referring at [260(5)] and [260(6)]. Rather, we consider that the FTT's finding was that Englehard started paying 99.75% but subsequently paid only 99.5% with the FTT unable to determine when it started paying the lower price.

15. Importantly, the prices at which Stirling purchased and sold were calculated by reference to the spot prices for "fine gold" which is essentially pure gold. The items that Stirling purchased would rarely, if ever, consist entirely of fine gold. For example, only 9/24ths of a 9 carat gold ring would consist of fine gold and therefore, when presented with such a ring for purchase, Stirling would need to factor in its assessment of the purity of the item into its determination of the purchase price.

16. Stirling would not sell gold coins to Englehard. That was because Englehard would pay the same for gold whether it was scrap, or worked into fine jewellery or coins and Stirling could make a slightly higher profit by selling coins of numismatic interest to dealers ([97]).

17. Stirling sold the gold that it purchased to Englehard on a daily basis. It did not consciously seek to retain gold so as to speculate on changes in the price. However, even though the FTT found ([106]) that Stirling's business was not a "gamble on price movements" it necessarily had some exposure to movements in the gold price. That exposure arose in part because, each working day before 10am, Stirling would agree to sell a specified amount of fine gold to Englehard at the "morning fix" of the gold price (see [113] and [114]). However, some of the gold that Stirling used to honour its obligation to Englehard would be bought by reference to a gold fix different from that used with Englehard. For example:

> (1) Stirling bought gold from its customers in both the morning and the afternoon. If the gold price was moving rapidly, or if it was asked, Stirling would use the afternoon fix of the gold price for purchases taking place in the afternoon.
>
> (2) The amount that Stirling agreed to sell to Englehard each day was necessarily based on an estimate of the amount of fine gold that would be present in the total amount of scrap gold that Stirling expected to purchase that day. The FTT found, at [115], that this was not an "exact science" and that Stirling might purchase more, or less, gold from its clients than it had contracted to sell to Englehard. If it sent more gold to Englehard than it had contracted to sell the surplus was "forward sold" at the next day's rate ([114]).

The FTT's findings of fact relating to Stirling's record-keeping

18. At [102] to [104], the FTT made findings as to the extent of Stirling's increase in turnover at times material to its appeal.

19. In APE 2006, its turnover was £2,961,000. This leapt to £12,856,000 in APE 2007, the first year in which it became involved in large-scale purchases of gold, before falling back to £5,285,013 in APE 2008 and £5,547,708 in APE 2009. APE 2010 saw a significant increase in turnover to £50,730,246 and in APE 2011, turnover was still higher at £143,802,126. The figure for APE 2012 was £206,081,126.

20. At [116] to [140], the FTT explained in some detail how the increase in Stirling's turnover led to frenetic activity to which it referred as the "gold rush". An aspect of that gold rush was Stirling's daily need for large sums of cash. Stirling's customers selling gold expected to be paid in cash as that was how they paid their own customers ([119]) and as the scale of Stirling's business increased so did its need for cash. Difficulties arose because Stirling could not always obtain the large quantities of cash it needed. In such situations, Stirling would issue handwritten IOUs to its customers. The FTT made clear findings that Mr Ragonesi, and his regular customers, maintained high standards of commercial integrity. Four of Stirling's regular customers were prepared to attend the FTT to give evidence on Stirling's behalf. Despite the large quantities of cash and gold changing hands, none of them complained that they had been short-changed or subject to sharp practice.

21. The fast-moving nature of Stirling's business, its reliance on cash and paper IOUs meant that there were "several obvious inadequacies with [Stirling's] record-keeping and mercantile habits" ([141]). The parties were not agreed as to the precise extent of the FTT's findings in this regard and we will return to that issue when we analyse the parties' respective appeals later in this decision. For present purposes we simply give a flavour of the FTT's overall findings.

22. At [143] and [144], the FTT said:

> 143. The Appellant's 'back-office' - book-keeping, invoicing, cash management and control - were (perhaps) appropriate for the type and size of business up to and including APE 09, where annual turnover was approximately £5m.
>
> 144. But thereafter, beginning in APE 10 (when turnover increased to approximately £50m) the position changed dramatically. However, the Appellant (for the detailed reasons set out below) failed to change with sufficient agility to keep pace with the increased turnover and focus of the business.

23. At [197], the FTT expressed the point slightly differently saying:

> 197. The deficiencies in record-keeping particularly affected the years up to and including APE 11.

24. At material times, Stirling's books were kept by Ms Barbara Mullinder. While the FTT was clearly impressed by her intelligence, meticulousness and honesty, it observed at [146] that she was not a trained accountant, or even a formally trained book-keeper.

At the height of the "gold rush", she was charging Stirling just £700 to £800 per month for keeping its books and the FTT said:

> On any view, the Appellant was appropriating a miniscule proportion of its resources towards keeping its books in proper order. This was a glaring false economy.

25. At [147], the FTT criticised Stirling's reliance on Ms Mullinder in the following terms:

> …the Appellant's continued reliance on Ms Mullinder (i) when the turnover of the business increased from about £5m in APE 09 to about £50m in APE 10, and (ii) when the focus of the business (again, in APE 10) changed from retail to [to] buying scrap and bullion, was a significant management failure by Mr Ragonesi, and therefore a significant management failure by the Appellant.

26. At [150], the FTT found that Stirling had no electronic invoicing system at all at its premises to deal with gold-buying until a computer system was introduced in February 2010. Therefore, until February 2010, Stirling's books depended on manual carbon-copy purchase invoice books and manual calculations made by Ms Mullinder using her calculator and at [151] to [160] the FTT set out a number of defects with that system.

27. The computer system, when introduced, did not improve matters greatly. At [174], the FTT found that:

> 174. The original computer system was frankly amateurish. We would go so far as to say that it was not really a 'system' as such. It was simply a surrogate typewriter, and not a very good one at that. It did not seem to represent any significant step forward in improving the quality or reliability of the Appellant's record-keeping. Paradoxically, in some respects, it seemed to have been somewhat worse - less satisfactory and less immune from error - than the carbon-paper based system which it was aiming to replace.

28. The defects associated with Stirling's financial records were laid bare in March or April 2010 (during APE 2011) when Ms Mullinder returned to work after she had been away for eight weeks because of an operation. On her return, no matter how hard she tried, she could not balance the books as there was a discrepancy of £4.23m in the recorded cash position. She raised the matter with Mr Ragonesi, asking him if he "happened to have £5m in the safe". She got nowhere in her discussions with Mr Ragonesi as to how the shortfall should be resolved beyond a confirmation from him that he kept between £500,000 and £600,000 in cash. The FTT described, at [192], the way in which Ms Mullinder ultimately decided to deal with the discrepancy:

> In August 2010 she decided - in good faith, and approaching the matter as a book-keeper, and with the need to 'balance the books' taking priority over all over features - to post this £4.23m discrepancy as a loss split across a number of months' trading. She explained this as she thought it 'prudent' to break it down into months "rather than put the big £4.2 through as a lump sum". When it came to the amount per month, she had Mr Ragonesi's £500,000 to £600,000 figure in her head. We wish to

> emphasise that there is no suggestion - and we do not find - that this was [not][3] done by her with any ill intent. It was certainly not done with any intent on her part to mislead or deceive. But it was not a sensible thing to have done since it effectively disguised the discrepancy in the books. Mr Ragonesi should not have allowed this to happen.

29. The FTT concluded that Stirling's record-keeping procedures improved markedly from APE 2012, partly because Mr Ragonesi approached Mr Peter Bosley, a qualified accountant and Fellow of the Institute of Chartered Accountants, to "bridge the gap between Ms Mullinder as a book-keeper and Mr Ragonesi as the director". Mr Bosley made changes to systems and focused on the preparation of running management accounts ([202]).

30. The FTT made clear factual findings, which are not challenged in either party's appeal, that Stirling's failures were limited to the quality of its records and record-keeping processes. There was no attempt to "extract" money or gold from the business, or "suppress" takings so as to evade tax. At [338] to [340] it said:

> 338. Mr Ragonesi repeatedly and firmly denied in his oral evidence - consistently with what he is recorded as having said to HMRC for several years - that he did not take any money or gold from this business. His denials were unequivocal.
>
> 339. We believed him.
>
> 340. We are not simply taking Mr Ragonesi's denial and say-so as the 'be-all-and-end-all'. Looking at this realistically and objectively, as we must, then, unless Mr Ragonesi is a deceitful and manipulative individual of a high order (which, to avoid any doubt, we do not consider he is) then this huge amount of money and/or gold would, in all likelihood, have left some trace, somewhere. But there is none.

The FTT's determination of Stirling's profits for APE 2011

31. Much of the debate and evidence before the FTT related to Stirling's profits of APE 2011 which the FTT described at [219] as the "factual and legal heart of the appeal". The focus on APE 2011 was, to a significant extent, driven by the way in which HMRC had chosen to make their assessments and closure notices. As recorded at [61] and [62], HMRC's pleaded case was that in APE 2011, Stirling had overstated its cost of sales in its tax returns and its true taxable profit was to be found by adding back 6.42% of the declared cost of sales so as to result in an increased taxable profit for that year. HMRC made that case for APE 2011 by reference to a detailed analysis of Stirling's financial records, unsatisfactory as those records were. They performed no similar analysis of Stirling's financial records for other accounting periods. Instead, they relied on the "presumption of continuity" to support an add-back of the same proportion of Stirling's declared cost of sales for all other accounting periods other than APE 2009 where, as noted at [62], HMRC applied a different metric.

[3] It seems clear that this "not" is a typographical error as the FTT is concluding that Ms Mullinder was not acting with any intent to deceive.

32. The defects in Stirling's records for APE 2011 posed clear challenges for all parties. However, following a "cash reconciliation" exercise that Mr Bosley performed, and on which HMRC's Mr Cope commented, the issues between the parties narrowed somewhat. For that accounting period, Stirling had claimed a deduction for £98,035,574 for cash purchases of gold, but could only show receipts for £88,956,885 (see [58]). HMRC accepted (see [218]) that Stirling could establish entitlement to a deduction for some or all of the "missing" £9,078,689 by means other than receipts. However, they argued that Stirling had not done so and that, accordingly, the entirety of this amount should be disallowed in APE 2011 and corresponding adjustments be made to the profits of other accounting periods applying the "presumption of continuity". By contrast, Stirling was arguing that it should be entitled to a deduction for some, or all, of the missing £9,078,689.

33. HMRC thought that the "cash reconciliation" exercise also identified that there were 24 days between February 2010 and November 2010 on which Stirling was open for business, but no receipts evidencing cash purchases of gold were available. At [245], the FTT concluded that there were only 23 such missing days as it accepted that Stirling's shop was closed on 6 April 2010. However, during the course of the dispute, Stirling discovered some purchase invoices for 6 of the missing days leaving the FTT in the following position:

> (1) For 17 of the 23 "missing days", the FTT had no evidence in the form of receipts for cash purchases of gold.
>
> (2) For 6 of the 23 "missing days", there were some receipts evidencing cash purchases of gold. However, because the total amount of those receipts (£614,325) was much less than the average for cash purchases on other days, which HMRC had calculated as £368,000 per day, Stirling argued that, for each of those 6 missing days, it should be treated as incurring cash expenditure of £368,000 on gold even though this was higher than the total shown in the receipts that had been discovered.

34. The "missing" £9,078,689 and the "missing days" reflected problems with Stirling's recording of expenditure that it had incurred. There was much less of a problem in quantifying Stirling's receipts, since Englehard sent Stirling self-generated invoices confirming purchases that it had made from Stirling and the FTT found (at [258]) that these invoices, being generated by Englehard rather than Stirling, were reliable and not affected by Stirling's poor record-keeping practice. Given the presence of reliable figures of sales to Englehard, Stirling suggested that its profits for APE 2011 could be determined by means of a "gold reconciliation" exercise under which data on the gold price was used to estimate how much the gold that Stirling sold to Englehard would have cost to buy. At [260], the FTT explained why it would not follow such an exercise and we will return to this passage when we consider Stirling's appeal against the Decision. Stirling also invited the FTT to follow an "anticipated profit margin" approach under which the cost of gold could be deduced by applying a margin to total receipts from Englehard. The FTT decided not to follow this approach either and gave reasons at [262] to [271].

35. Nevertheless, the FTT did consider that there was some benefit in considering conclusions that could be drawn from Stirling's total receipts from Englehard in APE 2011. At [262] to [269], the FTT noted that on HMRC's figures (that involved "adding back" the missing £9,078,689 when computing Stirling's profit for APE 2011), Stirling would be making a profit margin of up to 8.5% which it could only do if it were paying its customers 91% to 92% of the gold fix. At [267], the FTT concluded that it was "completely satisfied that the Appellant was paying more than that" and that in turn indicated that "something has gone non-trivially wrong with HMRC's figures in arriving at the assessment for APE 11 which is under appeal". However, the FTT stressed the limited conclusions that could be drawn from a consideration of Stirling's likely margin.

36. Instead of following a "gold reconciliation" or an "anticipated profit margin" approach, the FTT sought to reconstruct the amount that Stirling had spent on cash purchases of gold on the "missing days". It decided as follows:

> (1) On each of the 17 missing days for which no purchase invoices were available, the FTT decided that Stirling had spent £368,000 on cash purchases of gold (the average of the amount it spent on days other than the missing days) reasoning, at [245] and [248], that Stirling was open for business on those days and there was no reason to suppose that the turnover on those days was zero.
>
> (2) On the other 6 missing days, it decided that Stirling had spent just £645,000 in total, the amount substantiated by the receipts that Stirling had discovered. It rejected Stirling's submission that on each of those days, it should also be treated as making cash purchases of gold equal to the £368,000 average figure as being "to impermissibly 'mix and match' evidence".
>
> (3) Therefore, the total amount that Stirling had spent on cash purchases of gold in APE 2011 was the aggregate of (i) the £88,956,885 for which Stirling had produced receipts as part of the cash reconciliation exercise referred to above (ii) £614,325 and (iii) 17 x £368,000. That produced a figure for cash purchases of £95,827,210.
>
> (4) The FTT made some further adjustments to this figure in respect of opening and closing sales balances (see [252] to [254]) but both parties now agree that these adjustments were mistaken and neither seeks to defend them. Instead, both parties agree that the effect of the FTT's decision was that, while Stirling had claimed a deduction for £98,035,574 for cash purchases of gold in APE 2011, it was entitled only to a deduction of £95,827,210 and that its profits for APE 2011 should accordingly be increased by the difference between those two figures (£2,208,364).
>
> (5) By the time of the hearing before us, the parties were agreed that the effect of the FTT's decision was to increase Stirling's gross profit, before administrative expenses to £4,649,013 for APE 2011. Since Stirling achieved that gross profit on turnover of £143,802,136, it was common

ground that the FTT's decision implied that Stirling was making a gross margin of 3.24% on its total turnover for APE 2011[4].

The FTT's conclusions in relation to other accounting periods

37. As we have noted, HMRC's assessments and closure notices for periods other than APE 2011 were based on what it considered to be a correct application of the "presumption of continuity".

38. At [274], the FTT set out a quotation from the decision of Walton J in *Jonas v Bamford (Inspector of Taxes)* [1973] STC 519 on the nature of that presumption as follows:

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

39. At [277], the FTT found that the presumption of continuity applied to APE 2010 with the result that the profits of that accounting period fell to be increased by reference to the same proportionate add-back of expenses claimed for cash purchases of gold as had been made for APE 2011. Neither party seeks to disturb that conclusion in the appeal to this Tribunal.

40. At [281] to [282], the FTT refused to apply the presumption of continuity when determining the profits of periods from, and including, APE 2012 reasoning, broadly, that Stirling's record-keeping procedures improved and were reliable from APE 2012 onwards.

41. HMRC do, however, challenge the FTT's refusal to apply the presumption of continuity in relation to accounting periods before, and including, APE 2009 which were set out in [278] to [279] of the Decision. Those paragraphs were the focus of many of HMRC's submissions and so we will return to them when considering HMRC's appeal.

Stirling's grounds of appeal and overview of the parties' respective positions

42. The Upper Tribunal has granted Stirling permission to appeal on the following grounds:

> The FTT erred in law, applying the principle set out in Edwards v Bairstow, in concluding that the Company's profits for its accounting period ended 31 January 2011 were overstated by £2,372,595 as that conclusion was not open to the FTT in the light of the following findings

[4] In the remainder of this decision, when we refer to Stirling's "margin", we should be taken as referring to its gross profit (before administrative expenses) expressed as a percentage of turnover.

> of the FTT and/or unchallenged evidence before the FTT and/or matters on which judicial notice should have been taken:
>
> 1. The Company's profit margin on sales of gold was 2%. (The FTT's calculation of additional profit produces a profit margin materially in excess of this figure.)
>
> 2. The additional profit the FTT determined had been earned did not appear in the Company's accounting records for the relevant period which the FTT found to be intact at the beginning of the next accounting period.
>
> 3. The FTT's finding that Mr Ragonesi did not misappropriate cash or gold belonging to the Company.
>
> 4. The FTT's findings to the effect that the Company did not have large reserves of cash available to it and in fact was perpetually short of cash.
>
> 5. The inherent implausibility of such a large amount of additional profit simply "going missing".

43. At the heart of Stirling's appeal are propositions about what it asserts to be the impossibility of achieving the gross margin that is implicit in the FTT's decision. That argument proceeds by reference to the following reasoning:

> (1) The FTT found that Stirling purchased scrap gold for at most 97.5% of the gold fix.
>
> (2) The FTT found, at [112], that Stirling sold scrap gold to Englehard for 99.5% of the gold fix. (It acknowledges that, at [260(5)], the FTT referred to evidence suggesting that for a period Englehard paid 99.75% of the gold fix).
>
> (3) The evidence before the FTT demonstrated conclusively that in APE 2011, Stirling had no material source of income other than the purchase and sale of scrap gold.
>
> (4) Because each day Stirling sold to Englehard gold that it purchased on the very same day, movements in the price of gold could have no material effect on its profit.
>
> (5) Therefore, Stirling's <u>maximum</u> possible margin was 2.25% (if one assumes that it sold gold to Englehard for 99.75% of the gold fix) or 2% (if it sold to Englehard at 99.5%) of the fix[5].
>
> (6) The FTT's decision, which implies a 3.24% margin was accordingly irrational and perverse.

[5] After the hearing, it occurred to us that there was a (slight) arithmetic infelicity in this submission. If Stirling bought at 97.5% of the fix and sold at 99.5% of the fix, on Stirling's approach its gross profit, before administrative expenses, as a percentage of gross turnover would be 2/**99.5** (or 2.01%). Similarly, if it sold for 99.75% of the fix, on Stirling's approach its gross profit as a percentage of gross turnover would be 2.25/**99.75** (i.e. 2.26%, rather than 2.25%). However, nothing turns on this minor arithmetic point and we will not discuss it any further in the remainder of the decision.

44. HMRC make the following broad points in response to Stirling's case based on its margin:

> (1) The dispute that was before the FTT was as to Stirling's cash position as HMRC considered that Stirling could not demonstrate that amounts it claimed to have spent on cash purchases of gold had actually been so spent. Since Stirling bore the burden of proof, the FTT was entitled to adjudicate on the dispute before it by (i) deciding how much Stirling could prove it had actually spent on cash purchases of gold in APE 2011 and (ii) making corresponding adjustments in APE 2010. The FTT was not obliged to "sense check" its conclusions on the issue that was between the parties by reference to figures on margin.
>
> (2) In any event, the FTT had given reasons why Stirling's margin could not be relied upon to ascertain its taxable profits, when rejecting Stirling's "anticipated profit margin" approach at [262] to [271] of the Decision. Stirling's appeal, therefore, was an attempt to resurrect arguments as to the merits of an "anticipated profit margin" approach which the FTT had given good reasons for rejecting.
>
> (3) There were too many imponderables for Stirling's averred margin on scrap gold purchases to operate as a "hard cap" on the amount of its taxable profit in the manner for which Stirling contended. First, there was considerable uncertainty as to what that profit margin actually was. Second, Stirling's core business involved making a small profit on a large turnover of gold. Small differences in margin could have a large effect on profit. Therefore, even if Stirling's other activities were "small or negligible" when considered alongside its low-margin, high volume, scrap gold business, those other activities could still produce material profit. That point is emphasised by the fact that Stirling's own figures suggested that its margin fluctuated considerably. Indeed, in HMRC's submission for months in APE 2011 in which no purchase invoices were found to be missing, Stirling's own figures suggested an implicit margin of 2.78%.

45. HMRC deny that the FTT perversely found that £2.5m had "gone missing" from the business. The FTT had made it quite clear that Stirling was operating in a "chaotic and cash-based environment". Its record keeping was such that it could not account for £4.23m that it thought it had spent, leading to Ms Mullinder making her book-keeping adjustment for APE 2011. The figure of £2.5m was a small fraction of Stirling's cash turnover and even if Stirling's submissions in this appeal are accepted in full there would still be significant expenditure for which Stirling could still not account.

Stirling's appeal – Discussion

The nature of the FTT's jurisdiction

46. The parties' submissions revealed a degree of disagreement as to the nature of the FTT's jurisdiction to determine Stirling's profits for APE 2011 and we will, therefore, start with some brief remarks on this issue.

47. In his skeleton argument, Mr Chacko put Stirling's case on this issue as follows:

> It is for the taxpayer to show that an assessment is too high. However, once it is established that HMRC have demanded too high a figure, the Tribunal must then work out what the correct amount should be on the basis of its own best judgment, without regard to the burden of proof. That is to say, where (here) the taxpayer had succeeded in showing that HMRC's assessment for APE 31 January 2011 was excessive (in fact dramatically excessive, amounting to c £4.5 million in tax), the Tribunal needed to make its own reasonable judgment of the true amount of profits, rather than reducing them (for the level assessed) only so far as the taxpayer could disprove them.

48. Ms Choudhury for HMRC submitted that the FTT's task was less extensive as follows:

> The FTT's jurisdiction was to do the best it could on the basis of the evidence and, as an expert Tribunal, but not itself conducting an audit or bookkeeping exercise, to arrive at the "best" figures which were then deemed to be the "right" figures (both arithmetically and jurisprudentially).

49. The FTT's power to displace the determination of Stirling's liability to tax for APE 2011 derives from s50(6) of the Taxes Management Act 1970 ("TMA") which provides, so far as material, as follows:

> (6) If, on an appeal notified to the tribunal, the tribunal decides—
>
> …
>
> (c) that the appellant is overcharged by an assessment other than a self-assessment,
>
> the assessment or amounts shall be reduced accordingly, but otherwise the assessment or statement shall stand good.

50. Mr Chacko argued that his submission as to the scope of the FTT's powers was supported by the following passage from the decision of the Court of Session in *Rouf v HMRC* [2009] STC 1307:

> [29] In understanding the effect of [s50(6) of TMA], in our opinion, it is helpful to recall the observations made by Lord Hanworth, M.R., in *Haythornthwaite & Sons Ltd v Kelly* at page 667. There he said:
>
> > "Now it is to be remembered that under the law as it stands the duty of the Commissioners who hear the appeal is this: Parties are entitled to produce any lawful evidence, and if on appeal it appears to the majority of the Commissioners by examination of the appellant on oath or affirmation, or by other lawful evidence, that the appellant is over-charged by any assessment, the Commissioners shall abate or reduce the assessment accordingly; but otherwise every such assessment or surcharge shall stand good. Hence it is quite plain that the Commissioners are to hold the assessment standing good unless the subject - the appellant - establishes before the Commissioners, by

> evidence satisfactory to them, that the assessment ought to be reduced or set aside".
>
> Thus the general onus to show an overcharge lay upon the appellant. If the appellant had succeeded in showing that he had been over-charged, then, it would have been the responsibility of the Commissioners to make their own judgment, upon the evidence before them, as to the proper level of the assessment, to which the assessments would have required to have been reduced accordingly. As was recognised by Walton J. in *Bookey v Edwards* at page 491, that might have required Commissioners to make the best estimate that they could in the face of an unsatisfactory evidential position. However, before the Commissioners in this case came under an obligation to make the best judgement that they could of the appellant's liability, on the basis of the evidence, plainly they had to be satisfied that the appellant had been overcharged in the assessments made.

51. It is important to bear in mind the context in which the Court of Session made the above remarks. In that case HMRC had made an income tax assessment because they considered that the taxpayer had underdeclared his profits. In his appeal to the General Commissioners, the taxpayer made a number of criticisms of the basis on which HMRC made their assessments, but elected not to put forward any alternative figures to those contained in HMRC's assessment. He appealed to the Court of Session on the basis that the General Commissioners had dismissed his appeal solely on the basis that he had provided no alternative figures.

52. Therefore, in *Rouf v HMRC*, the Court of Session was not being invited to determine that the General Commissioners (or the FTT) had the kind of broad inquisitorial jurisdiction for which Mr Chacko appears to be arguing. Rather, the point at issue was much more limited: if the taxpayer could succeed in demonstrating that he was overcharged by HMRC's assessments, was his appeal nevertheless bound to fail if he did not provide a specific alternative to those assessments? In the passage we have quoted, the Court of Session resolved that issue by determining that in such a case it would still be open to the General Commissioners to reduce the assessment if there was evidence before them supporting that reduction. It was implicit in the Court of Session's conclusion that, provided it was supported by evidence, this course would be open to the FTT even if the taxpayer made no submissions suggesting a specific reduction. However, that is very different from a conclusion that the FTT must perform its own inquisitorial evaluation of the taxpayer's profits.

53. In any event, in *Rouf v HMRC*, the point was academic because the Court of Session concluded that the General Commissioners had quite properly decided that the taxpayer's general criticisms of the assessments did not demonstrate that they were excessive.

54. It follows, therefore, that we do not accept that the FTT had a duty to perform the broad examination for which Mr Chacko appears to be arguing. Once Stirling had demonstrated to the FTT's satisfaction that it was overcharged by HMRC's assessments, it could not simply hand matters over to the FTT and require it to perform its own examination and produce its own calculation of its true tax liability. Given the

clear defects in Stirling's records, both Stirling and HMRC had struggled to ascertain that true tax liability after examination and discussion lasting several months, if not years. It would be fanciful to expect the FTT to be able to do better if it simply performed its own analysis after a hearing lasting just a few days.

55. We therefore consider that Ms Choudhury's formulation of the nature of the FTT's task is closer to the mark. However, we would add an important qualification. Section 50(6) of TMA required the FTT to establish the amount of any overcharge in HMRC's closure notice for APE 2011 because it makes it obligatory for the FTT to reduce the assessment by that amount. In determining the amount of the overcharge, the FTT had to determine the true amount of Stirling's taxable profits in APE 2011. That was a finding of fact. Even if the FTT did do the "best it could" (to use Ms Choudhury's words) if, in making its factual finding, the FTT ignored relevant considerations, took into account irrelevant considerations, or came to a conclusion that could not be supported by the available evidence, its determination can be set aside under the familiar principle set out in *Edwards v Bairstow*.

56. The significance of this point can be seen in the case of *Rouf v HMRC*. In that case, HMRC made an assessment in respect of the profits of a restaurant business on the footing that 26.06% of turnover was not being declared. The evidence also showed that 8.09% of customers were not being recorded. The Court of Session concluded at [35] of the reported decision that, if the General Commissioners could not rationally have accepted that 26.06% of turnover was being suppressed when only 8.09% of customers were not being recorded, it was entitled to interfere with the General Commissioners' determination of the tax due on *Edwards v Bairstow* grounds. In the event, however, it declined to do so as it concluded that the General Commissioners' approach was rational.

57. Therefore, while we do not accept that the FTT had a broad inquisitorial jurisdiction of the kind for which Mr Chacko argued, neither do we accept HMRC's broad submission outlined at paragraph 44(1). We quite accept that both parties made submissions to the FTT about Stirling's cash position. However, the FTT's overall task was to decide whether Stirling was overcharged by HMRC's closure notice and, if so, by how much. It was not suggested to us that the parties reached any agreement that the appeal could be decided by reference to an agreed list of questions relating to its cash position. In short, the entire question of the amount of Stirling's profits for APE 2011 was at large before the FTT. It follows that, while the FTT was not under any obligation to "sense-check" its own determinations, since it was not performing an inquisitorial exercise, its overall determination of the level of Stirling's profits had to take account of the material factors to which the parties drew its attention and be "rational" having regard to those factors. If it can be shown that the FTT's determination did not meet those requirements, we are entitled to interfere with it.

The evidence and findings relating to the prices at which Stirling bought and sold

58. HMRC place significant reliance on what they submit to be the uncertainty as to the price which Stirling received from Englehard and the price that Stirling paid to its

customers. Without a high degree of certainty on both numbers, they argue that there can be no reliable "hard cap" on the amount of Stirling's taxable profits for APE 2011.

59. The difficulty with this submission is that it overlooks the fact that, as we explain in the next paragraphs, the FTT itself made factual findings that, in APE 2011, Stirling paid at least 97.5% of the spot price for scrap gold and received at most 99.75% of the spot price when it sold scrap gold to Englehard. On those findings, and ignoring other factors such as the presence of other sources of profit and the effect of fluctuations in the gold price which we will address in the next section, Stirling's maximum gross margin on sales of scrap gold was 2.25%[6].

60. HMRC referred to uncertainty as to when Stirling started to receive 99.5% of the spot price on sales to Englehard, as distinct from the 99.75% that it formerly received (see [260(5)] and [260(6)]). However, even if Englehard had paid 99.5% throughout APE 2011, that would only have reduced Stirling's margin below 2.25%.

61. In a similar vein, at [271], the FTT set out uncertainties associated with the price that Stirling paid for scrap gold as follows:

> 271 … 97.5% may well have been 'the default price', but this is not a reliable or immutable measure applicable to all purchases:
>
> (1) The price could and did change according to the identity of the seller. For example, Mr Scadeng would 'usually' (but not always) receive (according to Mr Scadeng) 'approximately 97-98%', but (according to Mr Ragonesi) 98%, so the evidence in relation to at least one of the largest counterparties is insufficiently reliable;
>
> (2) Ms Heighway, as Mr Ragonesi's 'second-in-command' or 'right-hand-woman' was also authorised to give different prices. She generally bought at 98% of the fix, but a few of the larger customers got a little bit more;
>
> (3) Coins were bought at 99% - i.e., at a premium over scrap;
>
> (4) On some occasions during APE 11, the percentage had not been re-set on the computer;
>
> (5) The Appellant almost always bought at the morning spot price, but sometimes changed its price to the afternoon spot price if there was a significant decrease - more than 1% - in the price over the course of the day.
>
> (6) The Appellant's profit margins in any event had to absorb the costs of transporting gold to the smelter, and the transaction cost of withdrawing large quantities of bank-notes from the bank every day.

62. We agree with Stirling that the points made at [271(2)] and [271(6)] could only operate to reduce Stirling's margin below 2.25%. We will deal with the point made at [271(5)] when we deal with the potential effect of gold price fluctuations and address

[6] Or, more accurately, 2.26% as set out in footnote [5]

the point at [271(3)] in the next section dealing with potential additional sources of income.

63. That leaves the points made at [271(1)] and [271(4)]. If Mr Scadeng sold gold to Stirling at 97% of the gold fix (at the bottom of the range he gave), Stirling would make more than a 2.25% margin when it sold gold purchased from him to Englehard for a maximum price of 99.75% of the fix. If there was a defect in Stirling's computer system so that Stirling was inadvertently paying less than 97.5% on some purchases, that could similarly increase the margin.

64. Mr Ragonesi's evidence as to the problem with the computer system was that, unless manually corrected, it would carry forward information from the previous invoice generated into the next invoice. As Mr Ragonesi put it in his witness statement:

> You would also have to manually clear the contents of the previous invoice before writing the new one…. If an important trade customer came in and you paid 99% of the fix, if you forgot to change it back you would be overpaying the smaller customers afterwards who I paid the basic rate of 97.5%. Once these were issued and money changed hands there was no way you could ask for the money back so we just had to deal with it.

65. That evidence was not challenged in cross-examination[7]. Therefore, the problem with the computer system could only result in a margin in excess of 2.25% on a particular transaction if Stirling paid a customer less than 97.5% of the gold fix and the computer replicated that amount on subsequent invoices. Yet Mr Ragonesi's evidence was that Stirling advertised that it would pay 97.5% of the gold fix and never paid less than this in APE 2011. We will shortly consider the effect of Mr Scadeng's evidence (that he was paid "97-98%" of the gold fix), but subject to that discussion, problems with the computer system could not themselves have increased Stirling's margin on any particular transaction above 2.25%.

66. The FTT found at [271(1)] that Mr Scadeng would "usually (but not always)" receive "97-98%" of the gold fix when he sold gold to Stirling. That finding was accurate, but was an understandably compressed way of stating a conclusion based on a few pieces of evidence. A fuller explanation of the situation with Mr Scadeng was as follows:

> (1) Mr Ragonesi's evidence, which was not challenged in cross-examination, was that "Andy Scadeng has been on 98 per cent for years".
>
> (2) Mr Scadeng's evidence was that the price he received started at 97% of the gold fix, increased to 97.5% and then increased to 98%. In 2011 and

[7] Mr Ragonesi was asked whether the reverse situation to that set out in his witness statement could arise so that a large customer who follows a small customer is inadvertently paid only 97.5% of the fix and is so underpaid. Such a mistake could not increase the margin on the transaction above 2.25%; it could only result in the large customer being underpaid as a result of receiving 97.5% of the fix rather than 99%. In any event, Mr Ragonesi's unchallenged evidence was that large customers knew what amount to expect and would have spotted any such mistake.

> 2012, he received 98%. In 2010, he thought the position was "maybe half and half" (from which we infer that his evidence was that in 2010 he received 97.5% on half of his purchases and 98% on the other half).

67. There was, therefore, no evidence before the FTT to support a conclusion that Mr Scadeng received less than 97.5% of the gold fix on gold he sold to Stirling in APE 2011 and so no evidence that Stirling's margin on transactions with Mr Scadeng was in excess of 2.25%.

68. We therefore accept Stirling's arguments that the findings of the FTT, and the evidence before it, demonstrated that in APE 2011 Stirling would purchase scrap gold for a minimum of 97.5% of the gold fix and would sell it to Englehard for a maximum of 99.75% of the gold fix. If that was Stirling's only activity, and ignoring the effect of fluctuations in the gold price, it could not have made a margin of more than 2.25%. In the sections that follow we consider whether other sources of income, or movements in the gold price, were capable of increasing Stirling's margin to the 3.24% implicit in the FTT's decision.

Other sources of income

69. At [96], the FTT found that the "main focus" of Stirling's business became the purchase and sale of scrap gold. It did not, however, make any express findings as to the scale of Stirling's other activities or the levels of profit they could generate. We agree with Ms Choudhury's general point that, in principle, other activities could generate material additional income even if they were less than the "main focus" of Stirling's business. We have, therefore, analysed the evidence before the FTT as to the scale of Stirling's other activities.

70. Mr Ragonesi's witness statement did not take matters much further than saying that the business of buying and selling scrap gold became the main focus of Stirling's business. However, he did explain that Stirling had started out as a jewellery retail business and had then expanded into wholesale and jewellery manufacture. After the "credit crunch" of 2008, he explained that manufacture and retail of jewellery became "more difficult" because the price of gold increased, making jewellery more expensive and people were less prepared to buy luxuries. By some time after 2008, Stirling had shut down all but two premises, retaining just one shop and one shop/wholesale premises.

71. Mr Ragonesi did, however, give unchallenged oral evidence that related to the scale of these other activities. He said that, in "2011"[8], Stirling did not even put retail goods out for display that the turnover for APE 2011 was "99.9-odd all bullion and odd rings". That echoed an answer he gave to a question to the effect that turnover in "2011 and 2012" was "all bullion...give or take… I couldn't say there isn't a few hundred pound ring or something". In "2010", Mr Ragonesi thought that around £45 million of turnover of £50.7 million was related to the purchase and sale of bullion.

[8] He did not specifically state that he meant APE 2011 but that was implicit.

72. We agree with Stirling that the evidence before the FTT indicated that the wholesale and retail sale of jewellery, and the activity of manufacturing jewellery, produced no material contribution to turnover in APE 2011.

73. The position in APE 2010 is much less clear-cut. While Mr Ragonesi's evidence certainly indicated that these other activities were much smaller than the activity of purchasing and selling scrap gold, they still generated material turnover of around £5m.

74. Another potential source of income available to Stirling took the form of revenue generated from extraneous metals found together with gold that Stirling sold to Englehard for example silver, platinum or palladium. The FTT made few findings as to the extent of this income. Having read the transcript of Mr Ragonesi's unchallenged evidence, it appears to us that the position with these metals was as follows:

> (1) Englehard would pay Stirling for extraneous precious metals such as platinum, palladium and silver that were mixed with gold sent for smelting.
>
> (2) If an item that Stirling purchased from its customer was perceived to contain platinum or palladium, Stirling would simply treat the platinum or palladium content as if it were gold and pay its customer accordingly. At the relevant time, the platinum price was "quite a lot" higher than the gold price, and the palladium price was less. Therefore, Stirling would make money on platinum, but lose money on palladium.
>
> (3) Silver was different. Stirling based the price it paid to its customer on its perception of the amount of gold that an item contained. While it was prepared to treat platinum and palladium as if they were gold, it did not do the same with silver. Therefore, if silver emerged from the smelt process, that could in some cases be, as Mr Ragonesi put it in his oral evidence, a "bonus" in the sense that Englehard would pay Stirling for that silver even though Stirling might not have fully reflected the item's silver content in the price paid to the customer. However, although it was a "bonus", revenue from silver would not have increased Stirling's overall profit significantly as the price of silver is much less than the price of gold and Mr Ragonesi's unchallenged evidence was that revenue from silver amounted to "about a quarter of a per cent profit" and it would typically be absorbed by "treatment charges and Englehard's charges".

75. Overall, it seems clear from Mr Ragonesi's evidence that revenue generated by Englehard paying for extraneous metals would have had some incremental effect on Stirling's gross revenues. However, given his unchallenged evidence that Stirling would make money on platinum, but lose it on palladium, and that the additional receipts from sales of silver did not have a significant effect on profit and would typically be absorbed by other charges, we see no basis for a conclusion on the evidence that Stirling made a significant amount of its gross profit from sums that Englehard paid for extraneous metals.

76. Finally, we turn to revenue from the purchase and sale of gold coins. The FTT found, at [97], that Stirling would not sell coins of numismatic interest to Englehard as it could make slightly more profit, which the FTT put at "perhaps 1%" by selling those

coins to specialist dealers. The FTT did not make any findings as to the scale of this activity. Mr Ragonesi's unchallenged evidence was that the activity was "in the scale of things not very important".

77. Our overall conclusion from a review of the evidence and the FTT's findings is that in APE 2011, Stirling did have sources of income other than the maximum 2.25% margin that it made on the purchase and sale of scrap gold. However, we do not consider that the evidence before the FTT supported a conclusion that these other sources of income could have had the effect of increasing Stirling's gross profit on total turnover from 2.25% to the 3.24% that was implicit in the FTT's determination. To have such an effect, these other sources of income would have to increase Stirling's gross margin by 44%. Yet there was no suggestion in the evidence that, either singly or cumulatively they could have had such a pronounced effect although, of course they would clearly have had some effect.

Movements in the price of gold

78. As we have noted at paragraph 17 above, Stirling did not consciously seek to speculate on movements in the price of gold. However, the ordinary conduct of its business necessarily meant that gold price movements could increase, or reduce, profits. The FTT did not make any findings as to the scale of this effect. However, Mr Ragonesi said in his witness statement that "[gold] price fluctuations were not a significant part of the profitability of the business" and that statement was not challenged in cross examination.

Other evidence supporting a conclusion that Stirling's gross profit was more than 2.25% of turnover

79. Ms Choudhury pointed out that Stirling's own evidence before the FTT suggested that it had a gross profit margin in APE 2010 of 2.54% which, she submitted, demonstrated that it was quite possible for it to make gross profits in excess of the "hard cap" for which it argued. However, as we have already noted at [73], in APE 2010 Mr Ragonesi's evidence was that Stirling sold material amounts of retail jewellery on which it made a gross profit of 10% to 20%. In APE 2011, by contrast, as noted at [71], there were negligible retail sales of jewellery. Therefore, the fact that, on its own figures, Stirling made a gross profit of 2.54% in APE 2010 says little about its likely gross profit in APE 2011.

80. Of more force was Ms Choudhury's argument that, in APE 2011, for months in which no purchase invoices were missing, Stirling's margin was 2.78% of total turnover. Mr Chacko invited us to attach little weight to this figure since it had been produced a long time ago by Stirling's former accountants and Mr Ragonesi's evidence in cross-examination was that the 2.78% figure had not been produced by considering actual receipts from Englehard relating to gold. It is not possible for us at this remove from the evidence to decide whether the 2.78% figure is accurate or not and, if it is, why it is higher than the "hard cap" for which Stirling argues. We observe only that, even if it is correct, the figure does not suggest that Stirling's margin for APE 2011 could be as high as 3.24% of turnover.

Conclusion on Stirling's appeal

81. The appeal before the FTT was unusual and raised difficult issues. Often when HMRC make assessments on traders with poor records, the central allegation is that the trader has "suppressed" receipts. However in this case, on the FTT's findings which are not subject to appeal, there is no question of "suppression". Rather, the question was how much Stirling could deduct from its receipts so as to produce taxable profits for APE 2011. The FTT faced an unenviable task in determining that issue given the chaotic nature of Stirling's business records and the corresponding multiplicity of methods that the parties put forward for consideration in order to fill in the gaps left by those records.

82. The "anticipated profit margin" approach for which Stirling argued had some attractions. Stirling's receipts from Englehard were, almost uniquely among Stirling's poor records, both complete and reliable. The "anticipated profit margin" approach sought to build on the accuracy of the Englehard receipts and the fact that those receipts built in a (relatively) predictable margin over amounts paid for gold so as to reconstruct the amount that Stirling actually spent on cash purchases of gold in APE 2011. We do not criticise the FTT for deciding that it would not follow that method as it was correct to observe that it came with a degree of uncertainty as to, for example, the precise prices that Stirling paid and received for gold.

83. However, the method that the FTT ultimately adopted, of seeking to reconstruct amounts paid on the "missing days" partly by reference to average figures and partly by reference to receipts also came with its problems. Most fundamentally, that method lost sight of the relatively predictable link between gross receipts from Englehard and amounts Stirling paid to acquire gold that arose because Stirling sold gold to Englehard for at most 99.75% of the gold fix and purchased gold from its customers for at least 97.5% of the gold fix. We will not go as far as Stirling and decide that this placed a "hard cap" on the amount of profit it could earn. As we have noted in the preceding sections, fluctuations in the gold price, income from the sale of gold coins which attracted a higher margin, the occasional sale of retail jewellery and receipts from Englehard relating to extraneous precious metals all had the capacity to increase Stirling's margin above 2.25% of total receipts from Englehard. However, the predictable link was highly relevant to a determination of what Stirling's profits for APE 2011 could plausibly be.

84. In the broad sense, the FTT did not "ignore" the link we have referred to in paragraph 83. It made careful and reasoned findings as to the nature of that link. However, at the crucial point in the Decision, when it was determining the amount of Stirling's profits for APE 2011, it lost sight of the significance of that link. As a result, it did not consider how Stirling could have made a gross margin of 3.24% when its business involved purchasing gold for a minimum of 97.5% of the gold fix and selling it to Englehard for a maximum of 99.75% of that fix. If Stirling had not put in issue the significance of its margin as a tool for estimating its maximum amount of profit (and had, for example, limited its submissions to the likely amount spent on gold on the "missing days") we would probably not have concluded that the FTT failed to take adequate account of the significance of Stirling's margin. As we have observed, the FTT was not exercising an inquisitorial jurisdiction and could scarcely be expected,

without invitation or guidance, to perform calculations to "sense check" its own conclusions. However, Stirling had placed its margin at the heart of its case. At paragraph 9 of its skeleton argument before the FTT, Stirling made the specific point that HMRC's assessments could not be based on an accurate estimate of its profits as Stirling could not earn the kind of margin that was implicit in HMRC's calculations. In urging the FTT to adopt a an "anticipated profit margin" exercise, Stirling was arguing that its margin was a reliable guide to the determination of its profits. The FTT had itself recognised the importance of Stirling's margin because it made findings going to the size of that margin. We do not, therefore, accept HMRC's submissions that, in making points about margin in this appeal, Stirling is "island-hopping" in the sea of evidence (in the words of the Court of Appeal in *Fage UK Ltd and another v Chobani UK and another* [2014] EWCA Civ 5 at [114]).

85. We have carefully considered whether the other factors, such as income from other sources and the effect of gold price movements, could nevertheless support a gross margin of 3.24%. In our judgment, while these factors demonstrate that Stirling could make a gross margin in excess of 2.25% of turnover, they do not support the figure of 3.24%.

86. It follows, in our judgment, that the FTT's conclusion as to the profits of APE 2011 is vitiated by errors of law. First, at the point it came to determine the level of Stirling's profits, the FTT ignored a relevant consideration: namely that Stirling bought gold at a minimum of 97.5% of the gold fix and sold it for a maximum of 99.75%. Second, the FTT's overall conclusion that Stirling made a 3.24% gross margin in APE 2011 could not be justified on the basis of the FTT's other findings and the evidence before it. In reaching this conclusion, we would not want to be seen as being unduly critical of the FTT as Stirling's chaotic records made the FTT's task extremely difficult.

87. We are therefore allowing Stirling's appeal by reference to its first ground set out at paragraph 42 above. In the circumstances, we do not need to consider the other arguments that Stirling raised in support of its appeal.

HMRC's grounds of appeal and overview of the parties' positions

88. With the permission of the Upper Tribunal, HMRC appeal against the Decision on the following ground:

> The FTT erred in law, including in the sense set out in *Edwards v Bairstow*, in concluding that [Stirling] had rebutted the presumption of continuity in relation to the profits of its accounting periods ended 31 January 2007, 31 January 2008 and 31 January 2009. Accordingly, the FTT erred in law in failing to conclude that [Stirling] had additional profits subject to corporation tax in those accounting periods.

89. The essence of HMRC's arguments, which we will consider in more detail in the sections that follow, is that in APEs 2007, 2008 and 2009, Stirling was carrying out a business of a similar nature to that carried out in APE 2011 and of a significant scale. Moreover, its records, and record-keeping procedures, were just as chaotic in those earlier accounting periods as they were in APE 2011. Accordingly, in those earlier

accounting periods, Stirling's expenses should be added back in the same proportion as they were added back in APE 2011 applying the presumption of continuity and the FTT reached a perverse and irrational conclusion in failing to do so.

90. HMRC argue that the comparison with APEs 2012, 2013 and 2014 is instructive. The FTT declined to apply the presumption of continuity in those accounting periods principally because it concluded that Stirling's record-keeping improved so that all purchases of gold were being reliably recorded. HMRC are content with that conclusion and do not seek to disturb it. However, having concluded that better record-keeping in APEs 2012, 2013 and 2014 made all the difference, the FTT could not rationally have declined to apply the presumption of continuity in APEs 2007, 2008 and 2009 when record-keeping in those years was no better than it was in APE 2011.

91. Stirling argues that the FTT was entitled to reach the conclusion that there were material and relevant differences between APEs 2010 and 2011, and the earlier accounting periods.

HMRC's appeal – Discussion

The "presumption of continuity"

92. At paragraph 38 above, we have set out a quote from the judgment of Walton J in *Jonas v Bamford*. Mr Chacko was right to emphasise, in his oral submissions, that the question is whether it can be presumed from the fact that Stirling under-reported taxable income in APE 2011 (by overclaiming expenses) that Stirling also under-reported taxable income in APEs 2007 to 2009. The question is not simply whether it can be presumed from the fact that Stirling's record-keeping was poor in APE 2011, that it was similarly poor in APEs 2007 to 2009. Of course, we acknowledge that HMRC's argument is that poor record-keeping in the earlier accounting periods would have caused just the same proportion of overclaimed expenses in that accounting period as it did in APE 2011. However, it is important to note that the presumption is focused on the amount of taxable income.

93. The focus of HMRC's challenge was to the reasons the FTT gave at [278] for not applying the presumption of continuity in APEs 2007 to 2009 as follows:

> 278. In relation to the earlier APEs, up to and including APE 09, we reject HMRC's case that the presumption of continuity operates so as to permit it to raise assessments by retrospectively applying the discrepancy percentage for APE 11:
>
> (1) The presumption is just a presumption, and can fall to be displaced by a taxpayer;
>
> (2) There is a clear difference - both quantitatively and qualitatively - between APE 09 and APE 10. In APE 09, the business was much smaller, and did not deal mainly in bullion, but was retail and the recycling of scrap gold jewellery to sell as jewellery.
>
> (3) The book-keeping procedure and Ms Mullinder personally were under much less pressure;

> (4) The only year which HMRC looked at in tremendous and forensic detail was APE 11;
>
> (5) HMRC had not performed the same exercise which it had undertaken for APE 11 for any of the earlier years, although it could have done. HMRC said that it had 'effectively absorbed' the inquiries for APE 07 and APE 08 into the APE 11;
>
> (6) APE 11 was the principal focus of HMRC's questions and the Appellant's answers.
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> 279. We are persuaded that the Appellant has shown us enough to displace the presumption for the years before APE 10.

94. We see little force in HMRC's criticism that paragraph [278(1)] does not contain any reason for declining to apply the presumption. In that paragraph, the FTT is simply directing itself, correctly, that the presumption can be rebutted. Its reasons are therefore to be found in paragraphs [278(2)] to [278(6)], reading those paragraphs in the light of the Decision as a whole.

95. As regards [278(2)], HMRC acknowledge that there were some "quantitative" and "qualitative" differences between APEs 2007 to 2009 and APE 2011. Stirling's business was smaller (though HMRC note that it remained large in all those accounting periods and had grown to £12.856m in APE 2007) and it was less focused on the purchase and sale of scrap gold. However, in HMRC's submission, these differences could not justify or explain the FTT's refusal to apply the presumption of continuity given that the poor record-keeping that led to Stirling's under-declaration of tax in APE 2011 was just as present in the earlier accounting periods and was not corrected until APE 2012. HMRC refer to a number of findings of the FTT relating to poor record-keeping in the early accounting periods[9]. At [158], for example, the FTT found:

> 158. This system was self-evidently inadequate. Firstly, it was entirely dependent on the books being kept fully and accurately, so as to record each and every transaction. But this was not happening. There were several books on the go at once, and a real possibility of transactions not being recorded at all or of being recorded incompletely or inaccurately. No-one could say for sure was happening. No-one was checking. We are quite sure that transactions were not being properly recorded.

96. HMRC point out that the "system" which the FTT was criticising in this paragraph was present in APEs 2007 to 2009 and did not change for the better until APE 2012. They submit that the FTT was not concluding that the poor first computer system, which was only introduced in APE 2010, was the cause of the problems because they made it clear at [178] that the new computer system simply failed to remedy existing defects in Stirling's record-keeping procedures. Moreover, HMRC argue that the FTT's finding at [143] that, up until APE 2009, Stirling's "back office" functions "were (perhaps) appropriate for the type and size of the business" was a less than ringing endorsement suggesting that even in the earlier accounting periods, the FTT was not satisfied as to the adequacy of Stirling's records.

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[9] For example, [150] to [153], [155], [158], [159], [160] and [189].

97. We do not, however, accept this criticism of the Decision as we do not consider that it properly takes into account the overall conclusion that the FTT was expressing. The problem Stirling had in APE 2011 was in keeping accurate records of large numbers of high-value transactions for the cash purchase of gold. Those difficulties were compounded by the fact that Stirling often did not have the cash with which to pay its customers immediately and so also needed to keep track of hand-written IOUs, a difficulty to which the FTT referred specifically at [140]. The FTT did, as HMRC submit, find that there were weaknesses with Stirling's record keeping regime that persisted from APE 2007 to APE 2011. However, the FTT's point was that, weak though they were, the poor system of record-keeping did not result in under-declarations of tax until Stirling's business increased dramatically in APE 2010 and started to involved purchases of large quantities of gold for cash, and, when Stirling had insufficient cash with which to pay its customers, the consequent need to keep track of numerous high-value, hand-written IOUs. That was why, at [143] and [144], the FTT drew a distinction between APEs 2007 to 2009 on one hand and APEs 2010 and 2011 on the other and why, at [278(3)], it referred to the book-keeping procedure and Ms Mullinder coming under "much less pressure" in the earlier accounting periods. It is also explained by the FTT saying at [149] that:

> The Appellant's back-office was just inadequate to keep track of the gold and money surging through the business.

98. The FTT's conclusion as we have explained it at [97] was supported by evidence. In APE 2009, Stirling's turnover was £5,547,708. In APE 2010 that increased to £50,730,246. In APE 2011 it increased to £143,802,136. The FTT was entitled to the conclusion that, in the face of this rapid increase in turnover, and the corresponding need to issue paper IOUs when Stirling did not have sufficient cash to pay its customers in full, Stirling's systems which had previously been "perhaps" appropriate for the previous type and size of its businesses, were no longer up to the task and led to expenses being overstated.

99. HMRC point out that Stirling's turnover in APE 2007 was also high, at £12.856m. However, Mr Ragonesi explained in his evidence that most of this turnover was attributable to a single transaction: the purchase and sale of a bedstead consisting of some 100kg of high carat gold. A single transaction of that size clearly would not place the same demands on Stirling's record-keeping systems as a large number of smaller transactions involving the same overall quantity of gold.

100. There was further evidence in the shape of witnesses' answers to oral questions. For example, in answer to a question from the judge, Ms Mullinder said in her evidence:

> I think the main problem at the time was that the business grew exponentially and it wasn't planned. I was the sole book-keeper. It could have done with some support which is why Mr Ragonesi brought in Mr Bosley. That made life an awful lot easier but everything was sort of down to me if you like, because the people that were operating the system they are not book-keepers, they are not accounts people. They didn't … understand the importance of getting the paperwork absolutely spot on.

101. Nor do we accept HMRC's submission that the FTT's reasoning at [278(2)] is undermined by the reasons given for not applying the presumption of continuity in APEs 2012 onwards. At [280], the FTT found that from APE 2012, Stirling's record keeping system was good and produced no errors. That does not undermine the FTT's conclusion that in APEs 2007 to 2009, Stirling's record-keeping procedures, while weak, were able to produce the correct determination of taxable income for the business of the nature and scale that Stirling was operating in those accounting periods.

102. That also deals with HMRC's criticism of the FTT's reasons at [278(3)]. HMRC submit that those reasons were without a foundation in the evidence. They argue that the deficiencies that led Ms Mullinder to make the quite extraordinary £4.23m adjustment in APE 2011 were present from APE 2007 onwards and the FTT made no findings that, in those accounting periods, when turnover was less, she was able to keep accurate records on the basis of that system. But that is to invert the FTT's reasoning. The FTT's finding, which was available to it, was that the sudden and dramatic increase in turnover, and the consequent reliance on handwritten IOUs in APEs 2010 and 2011 led to expenses being overstated. That reasoning necessarily involves a conclusion that there was a material difference between APEs 2007 to 2009 and APEs 2010 and 2011 so as to justify a conclusion that the presumption of continuity should not apply in the earlier accounting periods.

103. We tend to agree with HMRC that [278(4)] to [278(6)] do not set out reasons why the presumption of continuity is displaced. The fact that HMRC chose only to perform a detailed examination of Stirling's books for APE 2011 of itself says nothing about whether the presumption of continuity should be applied in determining Stirling's profits of APEs 2007 to 2009. However, read in context, we think the FTT is saying that HMRC's strategy in their enquiry was to focus on the profits of one accounting period and, if they were successful in adjusting Stirling's tax liability for that accounting period, to rely on the presumption of continuity to adjust taxable profits for all other accounting periods in dispute. It was entirely open to HMRC to adopt that strategy, but it left HMRC vulnerable to a finding that the situation in certain accounting periods was different from that in APE 2011 so that the presumption of continuity was rebutted in those accounting periods and no adjustment would be made to the profits of such periods. From HMRC's perspective such an outcome would compare unfavourably to the result that might obtain if they performed a detailed enquiry in all accounting periods in dispute. If they had done that, the FTT might well have been satisfied that some adjustment should be made to the profits of periods other than APE 2011 even if it felt that there were material differences between the situation in those periods and that of APE 2011. If that is the point the FTT was making in [278(4)] to [278(6)] we would respectfully agree with it. But even if the FTT was making some other point, it does not render perverse its finding that there were material differences between APEs 2007 to 2009 and APE 2011 for reasons that we have given.

104. For the reasons we have set out above, HMRC's appeal is dismissed.

Disposition

105.As we have noted, HMRC's appeal is dismissed and the sole remaining question is what direction we should make given that Stirling's appeal is allowed.

106.First, we are in no doubt that the errors of law in the Decision that we have identified at paragraphs 84 to 86 were material to it. We therefore set aside the Decision, insofar as it determines Stirling's taxable profits of APE 2010 and APE 2011. In all other respects that Decision is to stand.

107.We will remit the matter back to the FTT with a direction that it reconsider the extent of Stirling's taxable profits in the light of our conclusions at paragraphs 85 and 86 above.

108.We note that Mr Nicholas Dee, the FTT member, has retired since the Decision was released. We will not, therefore, prescribe the composition of the panel to which the appeal is remitted beyond saying that, to the extent practicable, it should include Judge McNall and Mr Dee to the extent that either or both are prepared, or able, to sit.

109.Since Stirling has not challenged the FTT's conclusion that the "presumption of continuity" applies in APE 2010, the FTT must, in the remitted appeal, as it did in the Decision, determine the profits of APE 2010 by applying the same principles and methodology as it applies when determining the profits of APE 2011.

110.In the remitted appeal, primary facts to which we refer in paragraphs 10 to 30 above are to be treated as established unless both parties agree otherwise. Beyond that, we do not consider it practicable to specify every finding of primary fact that is to be treated as established in the remitted appeal. However, we will say that we hope that the common-sense and co-operation between the parties that was apparent in the proceedings before us will continue in the remitted appeal and that the parties will resist any temptation to go-over well-trodden ground unnecessarily. We would add that we hope that the parties will be able to agree on a revised assessment so as to make a further hearing before the FTT unnecessary.

JUDGE TIM HERRINGTON

JUDGE JONATHAN RICHARDS

RELEASE DATE: 13 August 2020