[2016] UKFTT 0823 (TC)

TC05548

Appeal number: TC/2014/00090

INCOME TAX – incorrect returns – amendment to self-assessment return – whether expenditure incorrectly disallowed by HMRC – whether penalty assessed correctly

FIRST-TIER TRIBUNAL
TAX CHAMBER

ZAHIDA PARVEEN **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE FAIRPO
MARYVONNE HANDS

Sitting in public at Nottingham Justice Centre on 1 June 2016

Mr Z Iqbal, for the appellant
Mr Foster, presenting officer for the respondents

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DECISION

Introduction

1. This is an appeal by the appellant, Ms Parveen, against a closure notice and amendments to her self-assessment tax return by the respondents ('HMRC') for the tax year ended 5 April 2008.

2. Following correspondence between the parties, and a previous decision in this matter which had been set aside on the application of the appellant, the amendments (being disallowed amounts) which remained in dispute were agreed at the start of the hearing to be as follows:

(1) Rent: £2,401

(2) Rates: £3,984

(3) Further deductions: £4,217.46

3. A further amount of £7,470 had been disallowed by HMRC in respect of premises costs; the appellant in her witness statement accepted that £7,241 should be disallowed and HMRC agreed at the beginning of the hearing that they would accept this amount of £7,241 as the disallowable amount in respect of premises costs.

4. During the hearing, the appellant requested an additional adjustment to dispute the disallowance of the costs of two invoices for work done on the premises in relation to laminate flooring and a partition wall. Following discussion, it was agreed between the parties during the hearing that these were capital costs and the appellant's dispute in respect of these amounts was withdrawn.

5. The penalty rate was agreed between the parties to be 25%.

Background

6. The appellant carried on business in the tax year ended 5 April 2008 as a sole trader Her primary business was a daycare nursery; she also had income from a property rental business and from selling goods on eBay.

7. HMRC opened an enquiry into the appellant's tax return for that tax year on 9 June 2009; in the course of the enquiry, HMRC identified elements of the appellant's return which they considered to be incorrect. Those remaining in dispute are as follows:

(1) Deductions for rental payments in relation to the daycare nursery which HMRC considered to be excessive by reference to the tenancy agreement provided by the appellant and by reference to the District Valuer's report;

(2) Duplicate claims for rates in respect of the premises; and

(3) Deductions in respect of office equipment and work relating to the outdoor space, which HMRC considered should be regarded as capital expenditure

8. HMRC requested further information in respect of these items in a letter dated 30 October 2012. HMRC did not receive a response to that letter and so disallowed the expenditure, amending the return, and issued a closure notice on 28 December 2012 underpaid income tax and Class 4 National Insurance Contributions together with penalties thereon.

9. The appellant responded to the closure notice with a copy of a response to the letter of 30 October 2012 which she had sent to HMRC, dated 25 November 2012. This was treated as an appeal against the closure notice and the amendments to the return.

10. HMRC considered the additional information provided and revised the tax calculation, increasing the income tax and national insurance contributions due together with the penalty.

Relevant law

11. It is well established in statute that expenses may only be deducted in calculating profits of a business where the expense has been incurred wholly and exclusively for the purposes of that business.

12. Section 28A of the Taxes Management Act (TMA) 1970 provides that an enquiry into a return is closed by the issue of a closure notice which either confirms that no amendment is to be made, or makes an amendment to the return.

13. Section 95 of TMA 1970 also provides that, where a person negligently makes an incorrect return, that person will be liable to a penalty. Section 100 of TMA 1970 provides that the penalty may be reduced in mitigation.

Appellant's evidence and submissions

14. The appellant provided a witness statement and gave oral evidence. She submitted that explanations have been given for all of the expenditure in dispute, together with evidence, and that the explanations and evidence have not been taken into consideration properly by HMRC. Considering the amounts in dispute, the appellant made the following submissions:

Rent

15. The appellant contends that, in disallowing rental payments, HMRC had only taken into consideration one floor of the premises when considering whether the rental payments were reasonable, and had taken the two floors of the building as being separate.

16. The appellant stated that she had rented both floors of the building from Delstone Services Limited, and had internal access to the upper floor from the ground floor. There was also external access to the upper floor.

17. The ground floor rental was a fixed amount of £300 per week. The upper floor was used for meetings and training for the nursery. There were two large rooms, together with storage and toilet facilities on the upper floor. The appellant stated that she had begun to use the upper floor in April 2007, to see whether it worked for her needs, and then started to rent the space from June 2007. Payments were made from June onwards.

18. No tenancy agreement was in place for the upper floor as the appellant had not decided whether she wanted the space long term. Instead, it was submitted that invoices were raised by Delstone Services Limited on a usage basis, although the appellant accepted during the hearing that the payments were a fixed amount and not on a usage basis once she had started to use the space regularly from June 2007 onwards.

19. The agreement to use the space was verbal, as she did not want to lease the premises at the time. The appellant submitted that, although Delstone Services Limited was connected to her cousin, the relationship did not change the nature of the payments.

20. The appellant had produced the business diary showing the use of the space on the upper floor for meetings. The diary produced indicated that only one room of the two large rooms on the upper floor was in use at any particular time and that there were generally 2-3 meetings per week in the diary.

21. Photographs had also been produced, showing the rooms and the internal access from the group floor; the appellant confirmed that the internal layout of the property had been the same in the tax year in question.

22. The appellant queried the District Valuer's report and submitted that HMRC had not provided any evidence to show how the valuation had been produced.

23. The appellant further submitted that HMRC had not addressed the evidence that she had produced, including an estimate from a property letting agent, dated 23 January 2015, indicating that the rental value for the whole property in 2008 would have been £500.

24. The appellant noted that the accounts used to produce the return had shown total rent paid of £15,600 together with rates of £,3984.63. The amount claimed in the return was £21,984.73, being the four amounts of £4,500 shown in the cash book as actually paid during the tax year, together with a payment to the landlord for rates of £3984.73.

25. However, the appellant submitted that an analysis of the invoices for rent showed that the total rent accrued for the year was £27,500, as follows:

(1) Invoice dated 30 June 2007: £4,500

(2) Invoice dated 30 October 2007: £8,000

(3) Invoice dated 30 December 2007: £8,000

(4) Invoice dated 28 March 2008: £7,000

26. The appellant submitted that these amounts, together with a payment of £3,985 in respect of rates, had been confirmed in a letter from Delstone Services Limited which stated that this was the total amount of rental for the relevant tax year. This letter, dated 7 October 2015, states that the invoices related to rental charges for the ground and first floor of the premises and that the first floor was rented from 18 June 2007 to 30 March 2008 at a weekly rent of £350, to be invoiced on a pro-rata basis as and when used.

27. The invoices were provided as evidence in January 2016. The appellant explained that these had not been provided earlier because HMRC had not specifically requested them, although it was submitted that they had been included in the bundle of statutory records which had been provided to HMRC.

28. The copy invoices in each case state that they are for "1.0000 Rent" with no breakdown as to how the amounts have been calculated. The invoices do not state what premises are covered by the rent nor the period for which the amount has been charged.

29. The appellant submitted that these invoices had been omitted from her records because she was not an accountant; she had done her best with regard to maintaining business records but submitted that she was not very numerate or literate.

30. The appellant submitted that, therefore, no amount of the rent should be disallowed and, instead, that the amount allowed for rent should be increased by £9,500 to reflect the additional rent accrued which had not be reflected in the accounts, although it had been paid in May 2008.

Rates

31. The appellant submitted that there had been no duplication of amounts in respect of rates. It was explained that she paid an amount in respect of rates to Delstone Services Limited and that this was shown in the rent and rates ledger as £3,984, and had been included in the return as part of the 'rent and rates' costs.

32. The general purchases ledger, amounts included in the return as 'premises costs' further included the following amounts:

(1) 23 October 2007: £1,287 for 'business rates'

(2) 14 March 2008: £4,109.40 for 'annual bill – business rates'

(3) 18 March 2008: £96 for 'council'

33. The appellant explained that these amounts covered bin collection fees of £260 per year and water rates of £450 per year and that there had been a copy and paste mistake in the description of these amounts. The payments could also include a mandatory health and safety course training fee.

34. The appellant did not accept that there had been any duplication between the amounts in the rent and rates ledger and the amounts in the purchase ledger, although she had no evidence to explain the payments.

35. Evidence produced by HMRC, in the form of email correspondence with Derby City Council dated 20 January 2012, showed that the appellant was on record with Derby City Council as being liable for Business Rates from 5 April 2007 for the whole of the premises.

36. The appellant submitted that this was an administration error by Derby City Council, or that the landlord had advised Derby City Council that she was sub-letting the property.

Other invoices

37. Further invoices had been disallowed by HMRC, and the appellant submitted that these should be allowed as expenditure relating to the business.

38. The first disallowed invoice, from Nottingham Office Equipment for £717.46, was for a reception unit and five chairs. This invoice was dated 31 August 2007, for delivery on 3 August 2007. HMRC had disallowed this on the basis that it was a duplicate invoice, as there was a separate invoice from the same company for £676.21. for a reception unit and six chairs. This separate invoice was dated 30 August 2007, and marked for delivery on 3 September 2007. Both invoices showed a deposit payment of £17.46 and the balance to be paid on delivery. The price of the reception unit on each invoice was the same.

39. The appellant submitted that this was not a duplicate invoice: these were separate invoices, with separate payments and separate delivery dates for the equipment. The reception unit was in two parts, which could be purchased separately.

40. The appellant submitted that the equipment would have been written off in the same year that it was purchased, and so should be treated as revenue expenditure. Further, HMRC had allowed the second invoice as revenue expenditure and so should treat this in the same way.

41. The second invoice, from Ali Bye Building Contractors, had been disallowed as capital expenditure. This invoice was for £3,500. The work done was described as "clear and resurface outside space; lay down concrete levelling; resurface; clear refuse; block pave outside area; enclose with wooden panelling and install security gate; paint fence". The appellant provided photographs of the space to show the work that had been done.

42. The appellant explained that the space was cleared and resurfaced as a repair because the previous surface had become broken and had shrubs and other plants growing through it. Around 65%-70% of the originally surfaced area had to be replaced. It was submitted that this was a repair and so should be treated as revenue expenditure.

43. The concrete levelling had been laid down to deal with problems caused by drains not clearing properly. It was submitted that this was repair expenditure relating to the drains and so deductible as revenue expenditure .

44. The refuse cleared was barrels which had been dumped in the area by the pub next door, and these needed to be cleared before the block paving could be laid, although it would have needed to be cleared anyway. It was submitted that this was revenue expenditure, being effectively cleaning expenditure.

45. The block paving was agreed by the appellant to be capital expenditure, estimated by the appellant as being £1,000 of the total. This was block paving laid on the top of the resurfacing, not on the concrete levelling. The appellant submitted that this was specialist surfacing for a play area, and that Ofsted required specialist material to be used.

46. The fencing was estimated to cost £500 of the total, and the appellant accepted that this was also capital expenditure.

47. The appellant explained that the fencing enclosed the block paving; under the block paving was the concrete laid when resurfacing. The contractors had repaired and levelling the space underneath, then laid the resurfacing material and the block paving on top.

48. The appellant submitted that capital allowances should be available for the block paving and fencing as these were set up as a children's play area, for the nursery, and both were moveable.

HMRC evidence and submissions

49. With regard to the amounts in dispute, HMRC submitted as follows:

Rent

50. During the period of the enquiry, an HMRC officer had visited the premises and had been advised that the rental payments for the premises were £250-£300 per week, depending on the number of children and that, in addition, the upper floor was occasionally rented out. No indication had been given that the upper floor was continuously occupied for a period of over six months in the tax year, and no tenancy agreement has ever been produced in respect of the upper floor space. The appellant had also originally stated that she had no connection to the landlord, although she later admitted that the landlord was her cousin.

51. The amounts of the invoices are considerably in excess of the amounts set out in the tenancy agreement and have not been properly explained. The monthly average fluctuates but there is no detail in the invoices to explain why this is. The appellant had indicated that the invoices show her use of the upper floor, but HMRC submitted that there was no detail in the invoices to support this.

52. HMRC submitted that it was surprising that two invoices for £8,000 and one invoice for £7,000 had been omitted from the records and the accounts.

53. Accordingly, HMRC submitted that only the amounts shown in the accounts should be accepted as allowable, being £15,600 together with rates of £3,984, totalling £19,584. The additional £2,401 claimed in the return should not be allowed as the payments have not been shown to be wholly and exclusively for the purposes of the business. The further £9,500 which the appellant proposed should be allowed in addition to the amount claimed in the return should also not be allowed.

Rates

54. Having already allowed the amount of £3,984 for rates, as noted above, HMRC submitted that this amount had been duplicated in the general purchases ledger and included in general premises costs in the return. This amount had therefore been disallowed as a duplicate expense, reducing the general premises costs.

55. HMRC submitted that the appellant had not shown that the amount claimed in the general premises costs for rates was not a duplication of the amount already claimed together with the rental costs and that the disallowance should therefore stand.

Other invoices

56. HMRC submitted that the office equipment was capital expenditure and so was not deductible as revenue expenditure.

57. In addition, these invoices had not been included in the accounts and there had been no explanation as to where the funds to purchase the equipment had come from.

58. With regard to the work done by Ali Bye Building Contractors, HMRC submitted that the photographs provided indicated that the entire area had been replaced when resurfaced. As such, the expenditure should treated as capital expenditure as it amounted to more than mere repair.

59. HMRC submitted that the block paving should also be treated as capital expenditure and, as it had no specialist use (in contrast to, for example, a children's play area with spongy flooring), should be regarded as part of the setting of the business and so not eligible for capital allowances. There was nothing in the invoice to indicate that the paving was specifically intended for play areas, and the photographs did not suggest that it was designed for play areas.

60. The refuse clearing was, HMRC submitted, part of the resurfacing and so should be treated in the same way for tax purposes.

61. HMRC submitted that the concrete levelling to improve drainage was capital expenditure as it was more than a repair to the area and had replaced the area entirely.

62. The fencing was also submitted to be capital expenditure, and HMRC submitted that the description of the area as a children's play area of block paving on top of the resurfaced area, surrounded by fencing supported HMRC's submission that all of this expenditure was capital.

Discussion

63. In addition to the appeal as to disallowances, the appellant also sought to have further expenditure of £554 included as allowable in the return, although it had not been included in the return when originally submitted and had not been raised in correspondence with HMRC previously. The Tribunal did not allow this, as no previous claim had been raised in respect of this expenditure and the only evidence produced consisted of credit card statements with no detail as to the expenditure.

64. We note that the burden of proof in respect of deductibility of expenses is on the taxpayer to show that the expense was incurred wholly and exclusively for the purposes of the business.

65. With that in mind, we have considered each of the areas of dispute, as follows:

Rent

66. We note that various amounts in respect of rent have been raised at various points: the accounts figure of £15,600; the amount claimed in the return of £18,000 (based on four payments of £4,500), and the invoices provided which total £27,500.

67. The tenancy agreement produced in evidence refers to a lease of the ground floor only, at a rent of £300 per week. The appellant submitted that additional amounts were paid for the use of the upper floor; HMRC disallowed these additional amounts on the basis that these were excessive and so not incurred wholly and exclusively for the purposes of the business.

68. The appellant provided a diary, demonstrating use of the upper floor for meetings each week, and we find that the appellant did use the upper floor of the premises and that she held between 1 and 3 meetings per week in the space, with no more than one meeting at a time.

69. The appellant stated that she rented the upper floor at £350 per week from mid-June 2007 to the end of March 2008. This was originally stated to be on a pro-rata basis, although the appellant's evidence in the hearing was that the rent was fixed from mid-June onwards, rather than pro-rated although the original agreement was that the rent should be pro-rated as to usage.

70. Accordingly, the appellant's evidence is that she paid £350 per week for the entire upper floor of the premises, used for 1-3 meetings per week, and £300 per week for the ground floor of the premises used as a full time daycare nursery, a total of £650 per week.

71. We note from the appellant's evidence that she obtained an estimate from a local letting agent as to the rental value of the entire property in 2008, and that estimate was £500 per week, substantially below the combined amount which the appellant states she had agreed to pay for the period during which she was renting the entire premises.

72. On the basis of the appellant's evidence, therefore, she paid £300 per week for the ground floor from April to mid-June (approximately 10 weeks), and then a total of £650 per week (£300 for the ground floor and £350 for the upper floor) for the use of the two floors of the premises from mid-June to March 2008 (approximately 42 weeks). However, this would indicate a rental figure for the year for considerably more than the invoiced amounts.

73. The invoices provided in respect of rent do not provide any information as to the premises rented, the rental period covered by the invoice, or any calculation as to how the rental figure was calculated. As noted above, the amounts included in the invoices are also not consistent with the appellant's evidence as to the rent amounts paid each week.

74. We also note that the appellant paid an amount in respect of business rates to Delstone Services Limited, the landlord, although the appellant was the person on record with the local council as having responsibility for the business rates.

75. In the absence of any proper detail as to the amounts of the invoices, the inconsistency of the amounts set out in evidence as paid each week in comparison with the appellant's own evidence as to market rates, and the apparent invoicing of amounts for which the landlord was not liable, we do not consider that the amounts shown on the invoices are sufficient evidence to support the deduction of those invoice amounts for tax purposes.

76. As noted above, the burden of proof is on the taxpayer, on the balance of probabilities, to show that the amounts deducted for tax purposes are correct: although we find that the appellant used the first floor from time to time for meetings, we do not consider that the appellant has satisfied that burden of proof in respect of any rental payments in respect of that space. The amount stated to be payable is considerably in excess of the appellant's own evidence as to the weekly market rental value of the property at the time; the invoices provided do not have any indication as to the premises covered by the rental payment, the period covered by the invoice, or the method of calculation of the amount of the payment. The invoices are, further, inconsistent with the appellant's evidence as to the amounts payable. Accordingly, the appellant has not shown what amount, if any, should be correctly deducted for tax purposes in respect of her use of the upper floor.

77. We therefore take the view that the rent properly deductible is that stated in the accounts of £15,600 and that the additional amount of £2,401 claimed by the appellant in her return is disallowed, as is the further amount of £9,500 which the appellant raised as also being deductible in her witness statement.

Rates

78. We find that the appellant is the person on record with Derby City Council as having responsibility for the business rates for the entire premises.

79. We therefore find that the appellant paid rates direct to the Council and the amounts described as being in respect of rates in the general premises costs support this. We note that the appellant could not explain the amounts included in the general premises costs as being substantially anything other than rates.

80. It follows, therefore, that the payment of £3,984 to Delstone Services Limited also included in 'rent and rates' respect of 'business rates' must be disallowed as a duplicate amount of business rates.

Other invoices

81. Considering the two office equipment invoices, we note that both have the same deposit payment and the disallowed invoice, dated 31 August 2007, shows a delivery date of 3 August 2007 and requires payment on delivery. Both invoices show the same amount of deposit, and vary only as to the number of chairs.

82. The delivery date and requirement for payment on delivery on the disallowed invoice, both prior to the date of the invoice, are inconsistent with a reference on the invoice to payment of a deposit only – if the equipment had been delivered on 3 August 2007, 28 days before the invoice was produced, with payment on delivery, the invoice would have referenced payment in full.

83. We note that the appellant submitted that the reception unit could be purchased in two pieces, but there is nothing in the invoices to indicate that the reception units referred to were different items.

84. Accordingly, we find that this invoice was incorrectly produced by the supplier and the second invoice, allowed by HMRC, was produced as a replacement. It follows that this invoice, for £717.46, is disallowed as a duplicate.

85. With regard to the invoice from Ali Bye Building Contractors, we find that this was an invoice for a single project, creating a play area for the nursery. The elements of the invoice are clearly connected together, particularly given the appellant's description of the resulting fenced-in play area. As such, we find that the costs in this invoice are capital expenditure and, as the invoice does not indicate that any specialist materials were used, we find that the expenditure does not qualify for capital allowances.

Calculation

86. The Tribunal therefore finds that the closure notice and assessment dated 16 July 2013 is overstated and should be adjusted as follows:

(1) Rent and rates: original disallowance of £2,401 confirmed by this Tribunal

(2) Premises costs: original disallowance of £12,205 reduced to £7,421 by agreement between the parties

(3) Purchases: original disallowance of £11,702 reduced by £5,852 by agreement between the parties; £1,865 agreed between the parties to be disallowed; £3,984 disallowed, confirmed by this Tribunal

87. The further invoices of £4,217.46 were not included in the amounts of the amended closure notice and so their disallowance does not affect the amount of the closure notice.

88. The total amount disallowed is therefore £2,401 + £7,421 + £1,864 + £3.984 = £15,670.

89. The amount assessed is determined as follows:

Taxable profit per accounts		£8,371
Less additional expense permitted by HMRC		£(271)
Add amount disallowed		£15,670
Total profits		£23,770
Personal allowance for 2007-8		£(5,225)
Taxable profit		£18,545
Tax thereon:		
£2,230 @ 10%	£223.00	
£16,315 @ 22%	£3,589.30	
National insurance:		
£18,545 @ 8%	£1,487.68	
Total tax and NICs	£5,076.98	
Tax already paid	£(643.20)	
Tax to pay	£4,433.78	

90. The penalty rate was agreed between the parties to be 25% and the Tribunal did not consider that the agreement should be altered. The penalty is therefore calculated at £1,108.45.

Decision

91. The assessment to income tax and national insurance should be reduced to £4,433.78 (having taken into account the tax already paid). The penalty should be £1,108.545.

92. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ANNE FAIRPO

TRIBUNAL JUDGE
RELEASE DATE: 9 DECEMBER 2016