[2018] UKFTT 561 (TC)

TC06735

Appeal number: TC/2018/01824

INCOME TAX - application for closure notice under section 28A(4) Taxes Management Act 1970 – application granted

FIRST-TIER TRIBUNAL
TAX CHAMBER

RAJENDRAKUMAR PATEL **Appellants**

- and -

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

TRIBUNAL: JUDGE RICHARD THOMAS

Sitting in public at Taylor House, London EC1 on 24 August 2018

The Appellant as director of Ashley King Ltd, Chartered Accountants

Ms Amy Biney for the Respondents

© CROWN COPYRIGHT 2018

DECISION

1. This was an application by Mr Rajendrakumar Patel ("the appellant") to the Tribunal asking it to direct the respondents ("HMRC") to close the enquiry into the tax returns made by the appellant for the years 2014-15 and 2015-16.

Facts

2. On 15 November 2016 an officer of HMRC, J Broom, opened an enquiry under s 9A Taxes Management Act 1970 ("TMA") into the appellant's tax return for 2014-15. The enquiry was, the letter said, limited to three aspects, the remittance basis change, critical illness payments and licence fees. The first two matters ("the other matters") were settled in the course of the enquiry[1] with no amendments to the return required and are not further covered. The notice of enquiry contained a schedule requiring documentary evidence and of the licence fees.

3. Information given in a "white space" box in the 2014-15 return expanded on an entry in the return showing income of £85,000 in the box "other taxable income". The information simply said that the licence fees were received from Ashley King Ltd ("AK") described as the appellant's personal company. He added that the property from which Ashley King traded belonged to him and his wife but no rent was charged to AK and none would be. His pay from employment or office with Ashley King was shown as £9,000.

4. On 5 January 2017 AK sent a copy of the licence agreement dated 20 October 2003. The preamble recited that:

(1) the licensor was the appellant who is stated as practicing as a Chartered Accountant and had built up goodwill and considerable business contacts

(2) the licensor was the beneficial owner of the goodwill encompassed in the practice name Ashley King, Chartered Accountants and Chartered Taxation Advisers, which he had built up over many years.

(3) The licensor had built up a network of business contacts who introduce clients to the practice

(4) The licensee, AK, wished to exploit the practice name together with the network of business contacts.

5. The deed provided that the appellant, as licensor, would:

(1) make available to the licensee the practice name and the business contacts and would make necessary introductions

(2) register two domain names as owner but would them to the licensee

[1] In fact the notice attached to the letter of enquiry also asked for documents in relation to rents, but no amendments were made in relation to that issue either.

(3) develop a website for the promotion of Ashley King

6. In consideration the licensee would pay the licensor an annual fee equal to 20% of the gross fees charged to clients of AK in the preceding calendar year.

7. On 9 March 2017 J Broom wrote to AK about the other matters and said there would be a separate letter on the licence fees. That was because J Broom had asked for specialist advice. The request for advice was disclosed just before the hearing when the appellant asked for the disclosure of the submission made to technical specialists.

8. An email of 7 March from a redacted name to Shares and Assets Valuation ("SAV") suggested that the arrangements was to avoid NICs as the writer could not see where there could be goodwill to be licensed given the appellant's employment history.

9. In an email of 16 March 2017 a specialist in SAV gave advice to someone whose name was redacted about the subject "Mr Patel – Ashley King Ltd" and said that "goodwill can only exist in relation to a trade and since the trade was carried on by AK, the licence could not have been effective.[2]" Guidance was to be found in the CG Manual and in the case referred to there of *IRC v Muller* (*sic*) *Margarine*. The writer realised that there was not a valuation issue *per se* but said:

> "However the tax advantaged incorporations that the Chancellor put a stop to in 2014 have produced a great deal of correspondence here in SAV and we are well used to the kind of argument that can surface.[3]"

10. This guidance was reflected in a letter of 22 June 2017 from Mr P Floy, a more senior officer in "Wealthy and Mid-sized Business Compliance" (J Broom was in "Charities, Savings and International 1"). He asked for reasoned arguments supported by relevant case law and statutory references if the appellant disagreed.

11. On 27 July 2017 AK disagreed with a statement in Mr Floy's letter that the appellant had, before setting up AK, been "in the main" an employee of various firms as HMRC had said. In a letter of 14 October 2017 AK gave an account of the appellant's career in various accountancy firms as a salaried partner with a share in equity, who was able to take his own client base with him when he left, as well as his practice on his own account (as Ashley King) or in partnership in the years up to 2003.

12. By 29 November 2017 AK were showing exasperation that Mr Floy was again contacting specialist colleagues, and said the matter appeared to be drifting aimlessly.

---

[2] Nowhere does the point seem to have been considered that the appellant was a chartered accountant so was if anything carrying on a profession, not a trade.

[3] I have seen no further information in the papers to indicate what measure in the Budget or Finance Bill of 2014 was being referred to.

13. On 27 December 2017 Mr Floy gave notice of his intention to enquire under s 9A TMA into the 2015-16 return but said he did not need any information at the moment. The licence fee in that return was £80,000.

14. On 26 January 2018 AK made an official complaint about Mr Floy.

15. On 9 March AK set out what had or had not happened in the enquiry and said they would be seeking a direction from this tribunal to close the enquiry.

16. On 27 April 2018 Mr Floy, in response to another letter from AK, recapped the HMRC position and said that HMRC had not at this time come to a conclusion and needed further information as attached in a schedule. This asked:

(1) For a narrative showing how the appellant and AK had determined the level of salary at £9,000 and asked them to "provide evidence this" (*sic*) including but not limited to written correspondence, emails and contracts.

(2) A detailed description of the services provided by the appellant for (a) the salaried amount and (b) the amount received for the licensing of goodwill.

(3) An analysis (*sic*) of how the goodwill was valued.

(4) An analysis of how the amounts of the licence fees for "personal goodwill" (in quotes in the original) were calculated

(5) A calculation showing the reduction in goodwill from the opening balance reducing annually by the payments made by AK[4]

17. This letter was based on advice Mr Floy had received from another part of HMRC, "PT Customer Product Process" (*sic*) subheading "Employment Income Technical Team & [NICs] Technical Team" ("PT").

18. The subject heading of the request for this advice, dated some time in November 2017 and disclosed to the appellant shortly before the hearing, was (verbatim):

> "Other income – t/p potentially not paid any NICs as income maybe should have been classed as salary."

19. "Tax at risk" was shown as £0 and NICs at risk "estimated at £10,000 but not sure". The box against a question about "other enquires open on related cases, either individuals or company or partnership" said "none".

20. In the "summary of the issues and advice requested" box, Mr Floy had said the risk primarily concerned the licence fees and whether these constituted payment of salary rather than the licence fees related to personal goodwill and whether it would be PT's opinion that "we could raise an employment income charge and NICs liability on the licence fee payments."

[4] Me neither!

21. Mr Floy also referred to the appellant's citation of what he underlined was a non-tax case of *Sofra Bakery Ltd in liquidation*. He did not give his view of that case. The case law he listed as relevant was this case and *CIR v Muller and Co's Margarine* [1901] AC 217.

22. This time the name of the officer responding was not redacted; it was Mr John Stephenson. The response said that the question was "whether those payments truly consist of payments of licence fees in respect of goodwill or whether they should more properly construed as a payment of salary for services Mr Patel provided to the company".

23. Mr Stephenson was inclined initially to agree with a view that the payments were in fact payments of employment income and "as such should be liable to deduction of tax and NICs", but more information was needed. This was the information requested in Mr Floy's letter.

24. On 27 July 2018 Mr Floy issued a paragraph 1 Schedule 36 FA 2008 notice for the information. On 30 July AK appealed against it.

25. On 9 August 2018 Mr Floy gave the appellant (as AK had requested) his reasons for saying that each piece of information in the request was required.

26. The response was that Mr Floy needed the information to:

(1) Determine how Mr Patel and AK determined the salary shown on the return

(2) Deepen his understanding of the arrangements between Mr Patel and AK

(3) Understand the process and how Mr Patel and AK valued the level (*sic*) of personal goodwill transferred to AK

(4) Understand how the amounts paid in fees were quantified, as this would show how Mr Patel came to an agreement on the amounts of goodwill to be paid and over what period.

(5) To understand how Mr Patel has accounted for the goodwill and if AK has attained (*sic*) any goodwill by virtue of their own activities.

27. There matters stood at the date of the hearing.

Law

28. An enquiry into a return is governed by s 9A TMA:

> "(1) An officer of the Board may enquire into a return under section 8 … of this Act if he gives notice of his intention to do so ("notice of enquiry")—
>
> (a) to the person whose return it is ("the taxpayer'),
>
> ….

(4) An enquiry extends to--

(a) anything contained in the return, or required to be contained in the return, including any claim or election included in the return,

…"

29. The law on completion of enquiries is in s 28A TMA:

"(1) An enquiry under section 9A(1) … of this Act is completed when an officer of the Board by notice (a "closure notice") informs the taxpayer that he has completed his enquiries and states his conclusions.

In this section "the taxpayer" means the person to whom notice of enquiry was given.

(2) A closure notice must either—

(a) state that in the officer's opinion no amendment of the return is required, or

(b) make the amendments of the return required to give effect to his conclusions.

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

(4) The taxpayer may apply to the tribunal for a direction requiring an officer of the Board to issue a closure notice within a specified period.

(5) Any such application is to be subject to the relevant provisions of Part 5 of this Act (see, in particular, section 48(2)(b)).

(6) The tribunal shall give the direction applied for unless ... satisfied that there are reasonable grounds for not issuing a closure notice within a specified period."

30. The burden then is clearly on HMRC to say why the closure notice should not be given.

HMRC's submissions

Mr Floy's witness statement

31. HMRC's submissions were encompassed in Mr Floy's witness statement where his conclusion was that HMRC had not, at the time of writing, had an opportunity to come to a conclusion and set out a position to the appellant in relation to the enquiry into the licensing of goodwill.

32. It was HMRC's "initial" view that any goodwill present in former employments would not be "personal to Mr Patel" as there may have been significant input into the work from other professionals, and that from the information and documentation available it "would be" HMRC's view that the appellant would "potentially" have no personal goodwill to license.

33. This view was supported by technical specialists in SAV and Mr Stephenson, the technical specialist in PT, broadly agreed that the payments could be construed as salary, but further information was required to form a definite view.

Mr Floy's oral evidence

34. Mr Floy was cross-examined by the appellant who asked him why he had ignored the information about his career that he had supplied. Did that not show how he had created the goodwill?

35. The appellant asked Mr Floy if he had asked himself whether there were not more tax efficient ways he could have taken money from the business, eg by dividends.

36. In my view Mr Floy did not have a coherent response to those questions.

37. The appellant also suggested to Mr Floy that his submission to specialists was incomplete as to the facts. Mr Floy agreed that his submission did not contain the full facts.

38. I then asked Mr Floy some questions.

39. He confirmed that HMRC were not alleging that the licence agreement was a sham. How then, I asked him, were HMRC going to be able to show how the payments were not "truly" fees for licensing goodwill and other intangibles and how "construing" the agreement to pay such fees could result in their being salary instead? He had no coherent answer.

40. Mr Floy also said that there was no investigation or check into AK.

41. He agreed with me that if Class 1 NICs were payable then it was AK that would be liable to pay them. He agreed that if the payments were "truly" salary it was AK that would be liable to pay PAYE.

42. I asked him then to explain what amendment to the appellant's tax returns for 2014-15 or 2015-16 he would make to reflect his conclusion that the payments were salary. His answer was "none".

Conclusion

43. Although it was not cited to me, a case which is very relevant to this hearing is *Estate 4 Ltd v HMRC* [2011] UKFTT 269 (TC) (Judge John Clark and Mr Anthony Hughes) ("*Estate 4*"). That case concerned enquiries into the return of the appellant company. HMRC's argument for continuing the enquiry into Estate 4 Ltd's corporation tax return was:

> "*Arguments for HMRC*
>
> 36. Mr Lamb outlined the reasons why the information had been requested. The question was whether HMRC were justified in

> continuing to press for further information. HMRC contended that the officer, Mr Henry, had not been provided with sufficient documentary evidence or information to close the enquiry. In their view it was necessary to determine whether Estate 4, through its director Alessandro Crivelli, made day to day decisions on behalf of FCI and thereby acted as the permanent establishment through which FCI traded in the UK. HMRC also considered that the relationship between Alessandro Crivelli and FCI needed to be explored further. Mr Lamb referred to Gould, in which the Special Commissioner had decided not to issue a closure notice rather than directing a closure after six months. HMRC maintained that given the outstanding information and documents in the present enquiry, they could not be satisfied that the correct amount of income had been included in Estate 4's return.
>
> 37. The information was complex. It had been suggested that there was nothing wrong with Estate 4's accounts. This might well be the case, but there were other issues to follow up. The HMRC officer had to be satisfied as to questions such as that of Alessandro Crivelli's wealth. HMRC were not suggesting that anything in particular was wrong, merely looking at the possibilities. A large amount of information was still relevant before making the decision. Nothing Mr Wood had said in argument had changed the position; a reasonable position had been taken by HMRC. Mr Lamb asked that the appeal should be dismissed."

44. The Tribunal in giving its reasons why it ordered closure said:

> "40. The enquiries made by HMRC have been wide-ranging. Various matters discussed at the meeting between HMRC and the directors and accountants for Estate 4, and dealt with subsequently in correspondence, related to possible taxation liabilities of persons other than Estate 4 itself. Under paragraph 1 of Schedule 18, "tax" means corporation tax. Matters concerning the individual tax position of the directors in respect of their remuneration are therefore not directly relevant, and we understand why the letter dated 27 August 2010 from Barnes Roffe LLP stated, ". . . this does not enable you to ask general questions about the liabilities of other persons". However, we also understand why HMRC asked questions relating to the directors' remuneration, as the information in respect of this might have been shown to indicate that in some way the level of profits stated in Estate 4's accounts for the year to 31 December 2007 did not truly reflect the actual profits.
>
> 41. Having reviewed the information provided to HMRC, together with the evidence given by Mr Henry and Mr Thackeray, we find that it does not disclose any specific reason to suggest that this might be the case, and does not therefore form a sufficiently clear basis for continuing to make further enquiries into the level of the remuneration so far as the return of Estate 4 for the period is concerned. In order for us to have been satisfied to the contrary, we would have needed to have been persuaded that Alessandro Crevelli's explanation as to his financial resources was not adequate. None of the evidence presented to us was sufficient to draw us to such a conclusion.

> 42. In relation to Estate 4's corporation tax liability, our finding is that, for similar reasons, we are not satisfied that any of the information provided in evidence by HMRC is enough to suggest that the profits as stated in its return for the period are not correctly stated. Again, the generalised enquiries have not raised any specific issues which HMRC are in a position to demonstrate that they wish to follow up. HMRC have not given us any clear indication, with supporting evidence, of anything in Estate 4's return which needs to be subjected to further enquiry, nor have they established supporting evidence pointing to any respect in which the return may possibly be considered to be deficient.
>
> 43. Questions in relation to the potential UK tax liabilities of the Luxembourg and Italian companies in respect of profits which might be treated as derived from some form of trading operation in the UK are in our view peripheral to the enquiry into Estate 4's return. We accept that paragraph 25(1)(b)(ii) refers to "any amount that affects or may affect . . . the tax liability of another company for any accounting period", but in order to satisfy us on this basis that a closure notice should not be issued, it would have been necessary for HMRC to point to some specific amount in Estate 4's accounts for the period, and demonstrate why it was appropriate to continue enquiries into that amount.
>
> 44. In relation to the wider question of possible trading in the UK through a permanent establishment, we accept Mr Wood's argument that under s 6 of the Corporation Tax Act 2009, a company is not chargeable to corporation tax on profits which accrue to it in a fiduciary or representative capacity (except as respects any beneficial interest which it may have in those profits). The basis for imposing a charge to UK tax on profits derived by a non-UK resident company trading in the UK through a permanent establishment which happens to be constituted by a UK company is entirely separate from the liability and collection arrangements which apply to the latter's own profits. Any profits of the Luxembourg or Italian companies could not be treated as being within the scope of Estate 4's corporation tax return; this could only concern profits properly attributable to Estate 4's own activities and consequently potentially chargeable to corporation tax in Estate 4's hands."

45. In my view this case is if anything a stronger one than *Estate 4* for directing closure. Mr Floy's admission from the witness box that no amendments could be made, whatever the answer to his most recent questions in the Schedule 36 notice, settles the issue.

46. It is no part of my task in this case to decide the question whether there has been a loss of tax in relation to some person other than the appellant, and I do not do so.

47. But I cannot refrain from commenting on what HMRC has done here. The SAV advice that *Muller Margarine*, a case from 1901 (and a non-tax case – it was stamp duty) was determinative of the issue was given at a time when SAV must have known about *Sofra Bakery*. Mr Floy made his submission to PT after he had received the appellant's letter of 14 October 2017 where he comprehensively set out his career

details and why he was shown as employed at times but nonetheless was building up his own business. None of this was referred to at all by Mr Floy in his submission.

48. Mr Stephenson of PT is a technical specialist on the taxation of employment income. He must therefore know that Class 1 NICs are not collected from an employee. He was dealing with a submission that showed no tax at risk. I cannot understand why it was remotely sensible for him to suggest to Mr Floy that he should prolong the enquiry into the appellant's return by asking him questions that could only lead to tax being collected from another person, presumably AK. Mr Floy had made it clear that there was no enquiry in that company or anyone else connected with the appellant. Mr Floy told me from the witness box that he did not even know if the appellant was a shareholder in AK.

49. I therefore direct that HMRC must issue a notice to the appellant giving the conclusions of their enquires into the appellant's tax returns for 2014-15 and 2015-16 no later than 7 September 2018.

50. 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.

RICHARD THOMAS
TRIBUNAL JUDGE

RELEASE DATE: 26 September 2018