TC02094

Appeal number: TC/2011/02248

INCOME TAX – losses *- Set off of losses against general income –Section 380 ICTA 1988 – Restriction on set off under Section 384 (6)ICTA in relation to provision of "plant and machinery for leasing in the course of a trade" – Whether losses in relation to business involving yacht so restricted –Yes – Whether appellant negligent for purposes of showing pre-condition for discovery assessment under Section 29 TMA 1970 – No –Whether officer could not have been reasonably expected on basis of information available to him to be aware of insufficiency of tax assessment – Yes- Appeals against assessment for 2004-5, 2005-6, and 2006-7 dismissed –appeal against assessment for 2003-4 allowed on grounds discovery assessment out of time*

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR CHRISTOPHER JOHNSON **Appellant**

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
ELIZABETH BRIDGE

Sitting in public at 45 Bedford Square, London on 22 March 2012

Mr C. Johnson in person

Ms K. Weare for the Respondents

DECISION

1. This appeal concerns appeals by the appellant against the amendment to his Self-Assessment, for the year ended 5 April 2007 and discovery assessments under Section 29 Taxes Management Act 1970 ("TMA 1970") for the years ended 5 April 2004, 5 April 2005 and 5 April 2006.

2. In his returns for the years ended 5 April 2004, 5 April 2005, 5 April 2006 and 5 April 2007, the appellant declared self-employment income from a boat chartering business and employment income from Jupiter International Group.

3. The particular point at issue in this appeal is whether the boat chartering constituted a provision "of plant or machinery for leasing in the course of a trade". The appellant argues that the way in which the yacht is chartered amounts to a provision of services rather than the provision of plant or machinery for leasing and that he is therefore entitled to set losses arising from that against his other income. HMRC disagree.

4. The appeals had also concerned whether certain expenses were deductible but this issue had been resolved between the parties by the time of the hearing.

Evidence

We had before us a documents bundle produced by HMRC. This contained copies of correspondence between HMRC and the appellant, the appellant's self-assessment returns for the years under appeal and a copy of blank form agreement between Blu Team S.r.l and a boat owner. In his evidence Mr Johnson confirmed he had signed an identical copy – the original having gone missing when he had moved house. There was also a translation of a statement from Francesco Salghetti Drioli dated 27 October 2010 describing an incident which happened during a charter in 2010. We also heard oral evidence from Mr Johnson which was cross examined by HMRC.

Background Facts

5. From the documents and evidence before us we found the following facts:

6. The appellant took out a mortgage to fund the purchase of a yacht the "Hadriel" a Bavaria 49. The yacht cost £141,334. The appellant started his yacht charter business on 1 December 2003.

7. The boat is moored in Italy at a state of the art marina with shops and restaurants. It is close to the sailing area of the Tuscan archipelago and has easy access to Elba, Corsica and Sardinia and to picturesque harbours and places of interest.

8. The appellant was, during the periods covered by the assessments in issue, in full time employment (35 hours per week) with Jupiter International Group.

9. The appellant had an agreement with a management company, Blu Team S.r.l ("Blu Team") located in Italy. Mr Salghetti Francesco was a director of this company. The recital records the intention of Blu Team to rent and charter the vessel. In the agreement the appellant, as owner of the yacht, agreed to grant sole management rights over the vessel. After deduction of the monthly running expenses it was agreed that the net income be shared in the ratio of 78% to the appellant and 22% to Blu Team. The appellant was responsible for the insurance of the yacht. Blu Team was responsible for the following:

(1) Formalities regarding the withholding of the deposit in the case of damage occasioned by customers and the filing of insurance claims;

(2) Commercial and advertising costs of the yacht;

(3) Routine maintenance on the entire vessel and on its own accessories;

(4) Extraordinary maintenance covering repairs of damage caused by parties chartering the vessel;

(5) Embarkation and debarkation of crews, as well as passenger check-in and check-out;

(6) Internal and external clearing of the vessel at the end of each charter;

(7) Supply of accessories at the beginning of each charter;

(8) Storage, at its own facilities, of the accessories and spare parts required for serving customers and small urgent repairs.

10. Under the agreement Blu Team was to receive "technical management costs" to the amount of 180 Euro per charter.

11. The agreement also made provision for the appellant to use the yacht when it had not been chartered to another customer.

12. The appellant ran the business in his spare time. His yacht was an expensive asset and he kept in close contact with Blu Team. They would seek his approval on various pricing matters and regularly send him updates on the bookings on the yacht. The appellant would also attend boat shows to keep abreast of the competition.

13. The yacht business was advertised via website, word of mouth and at boat shows.

14. There was no documentary evidence as to the nature of the agreement with the customers who used the yacht. The appellant did not have example copies of these and we were told these types of arrangements were informal in that part of the world. We did however hear evidence from the appellant on the typical costs and details of the services which were provided.

15. The cost of chartering the yacht was in the range of 2000 to 5000 Euros depending on the time of season. The yacht takes up to 12 people so when that cost is split per person cost is not expensive and would therefore appeal to budget conscious customers. A skipper was not provided as that would significantly increase the cost.

16. The price included various items such as, provision of water and electricity while the yacht was moored at base, marina fees, free parking at the marina for the duration of the charter, marina berth for at least 2 weeks, and cleaning of the yacht.

17. Staff provided lengthy and detailed briefing to clients about the yacht, its safe operation and local sailing conditions, prevailing winds, information and rules and suggested routes. If severe weather conditions were known about then warnings were printed out. The staff assisted clients with boarding and meeting them on their return, they boarded in-bound yachts at the diesel berth and ensured they berthed safely back at the marina with no damage to the yacht. The water tanks were filled and equipment was inspected to ensure it was present and adequate.

18. Telephone support was also provided for issues while the charterer is away from base e.g. dealing with navigation equipment issues if it had been switched to the wrong language. The staff would go the assistance of the charterers should the need arise.

19. As an example we were told of a particular incident on 8 September 2010 where assistance had been required and shown a statement by the director of Blu Team describing what had happened. The yacht had got into difficulties due to adverse weather and been blown into shallows with the result that its rudder had been damaged. Blu Team was advised and made a rescue call. They made an inspection, organised for a spare to be sent and sailed the boat back to the marina.

20. The following items were also included: lifejackets, life raft, mooring ropes / fending and passarelle (boarding ramp), engine spares welcome pack of provisions, nautical pilot books, charts and navigation equipment, tender and outboard, catering equipment, propane gas for cooking, pillows and bedding.

21. The appellant's returns for the business showed income, expenses, profit, capital allowances and loss as follows.

	2003/4	2004/5	2005/6	2006/7
Income	Nil	16,908	16,302	15,700
Expenses	701	4,260	7,442	9,808
Profit	(701)	12,648	8,860	5,980
Capital allowances	48,000	26,168	18,209	13,657
Loss	48,701	13,250	9,349	7,677

22. The appellant claimed capital allowances on the yacht used in the charter business. The capital allowance figures were not disputed but the set-off of losses

which had been created by the capital allowances against the appellant's general income was.

23. On 14 October 2010 HMRC wrote to the appellant to set out its review of the appealable decisions and confirming its view that the losses were not available for relief against the appellant's general income. The appellant filed his appeal against the decisions on 12 November 2010.

Law

24. For the relevant years of assessment the legislation to set-off losses against general income of the same year is found at section 380 ICTA 1988:

> **380 Set-off against general income**
>
> (1) Where in any year of assessment any person sustains a loss in any trade, profession, vocation or employment carried on by him either solely or in partnership, he may, by notice given within twelve months from the 31 January next following that year, make a claim for relief from income tax on –
>
> (a) so much of his income for that year as is equal to the amount of the loss or, where it is less than that amount, the whole of that income; or
>
> (b) so much of his income for the last preceding year as is equal to that amount or, where it is less than that amount, the whole of that income;
>
> But relief shall not be given for the loss or the same part of the loss both under paragraph 9(a) and under paragraph (b) above.
>
> (2) Any relief claimed under paragraph (a) of subsection (1) above in respect of any income shall be given in priority to any relief claimed in respect of that income under paragraph (b) of that subsection.

25. Section 384(6) ICTA 1988 restricts the setting-off of Capital Allowances on assets (boat) provided for leasing in the course of a trade against other income under certain circumstances:

> **384 Restrictions on right of set-off**
>
> (6) There shall be disregarded for the purposes of sections 380 and 381 so much of any loss as derives from any allowances made to an individual under Part 2 of the Capital Allowances Act in respect of expenditure incurred on the provision of plant or machinery for leasing in the course of a trade unless –
>
> (a) the trade is carried on by him (alone or in partnership) for a continuous period of at least six months in, or beginning or ending in, the year of assessment in which the loss was sustained; and
>
> (b) he devotes substantially the whole of his time to carrying it on (alone or in partnership) throughout that year …."

(11) Expressions used in subsections (6) to (8) and in Part 2 of the Capital Allowances Act have same meaning in those subsections as in that Part; and those subsections are without prejudice to section 384A.

26. Section 29 TMA 1970 allows an assessment under the discovery provision to be issued. This is relevant for the years ended 5 April 2004, 2005, and 2006:

Taxes management Act 1970

PART IV

"29. Assessment where loss of tax discovered

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment –

(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or

(b) that an assessment to tax is or has become insufficient, or

(c) that any relief which has been given is or has become excessive,

the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax

….

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above –

(a) in respect of the year of assessment mentioned in that subsection; and

(b) … in the same capacity as that in which he made and delivered the return,

Unless one of the two conditions mentioned below is fulfilled.

(4) The first condition is that the situation mentioned in subsection (1) above is attributable to fraudulent or negligent conduct on the part of the taxpayer or a person acting on his behalf.

(5) The second condition is that at the time when an officer of the Board –

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or

(b) informed the taxpayer that he had completed his enquiries into that return,

The officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if –

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the board, are produced or furnished by the taxpayer to the officer …; or

(d) it is information the existence of which and the relevance of which as regards the situation mentioned in subsection (1) above –

(i) could reasonably be expected to be inferred by an officer of the Board from

(ii) are notified in writing by the taxpayer to an officer of the Board.

(7) In subsection (6) above –

(a) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes –

(i) a reference to any return of his under that section for either of the two immediately preceding chargeable periods;

…

(b) any reference in paragraphs (b) to (d) to the taxpayer includes a reference to a person acting on his behalf.

(7A) The requirement to fulfil one of the two conditions mentioned above does not apply so far as regards any income or chargeable gains of the taxpayer in relation to which the taxpayer has been given, after any enquiries have been completed into the taxpayer's return, a notice under section 804ZA of the principal Act.

(8A) An objection to the making of an assessment under this section on the ground that neither of the two conditions mentioned above is fulfilled shall not be made otherwise than on an appeal against the assessment.

(9) Any reference in this section to the relevant year of assessment is a reference to –

(a) in the case of the situation mentioned in paragraph (a) or (b) of subsection (1) above, the year of assessment mentioned in that subsection; and

(b) in the case of the situation mentioned in paragraph (c) of that subsection, the year of assessment in respect of which the claim was made."

27. We were referred to the following cases:

Appellant's arguments

28. The question of whether the arrangements were leasing or provision of services were dependent on the facts and a reasonable person would interpret the circumstances of the appellant's arrangements as being provision of services involving the use of an asset.

29. The guidance and support provided by Blu Team were not facilities provided with the yacht but services. Other services were the location of the yacht and the services provided in preparation of the yacht. The professionalism of the support provided by Blu Team, the quality of the marina and surrounding location were all part of the charterers' experience.

30. The importance of the services provided in a yacht holiday business distinguishes it from a commercial hire operation. They were particularly important to budget conscious customers and without the additional services the business would not flourish.

Respondent's arguments

31. The business of the yacht chartering was done through bareboat leasing. This was clearly a lease, the lessees paid rent and took responsibility for providing a crew.

32. The first indication the yacht was a leased asset was in a letter from the appellant to HMRC dated 22 September 2008. In response to an enquiry on his 2007 return the appellant had written under the heading "charter" – "Bareboat, but a skipper may be employed privately by the charterer."

33. The term bare boat charter as defined in Wikipedia is an arrangement where no crew or provisions are included as part of the agreement. Consistent with HMRC's guidance that a provision of a crane with a driver was a provision of service, as distinct from the provision of a crane without a driver which was leasing of the crane providing a yacht without a skipper was just leasing of the asset

34. In relation to the grounds for making a discovery assessment both the conditions could be made out. The appellant had been negligent in that he did not make full disclosure of the business in which losses arose. Alternatively he had provided no information that would have drawn attention to the claim until his return for 2006-7.

Discussion

35. The principal issue for the Tribunal's consideration was whether the losses deriving from allowances made to the appellant under the Capital Allowances Act were in respect of expenditure incurred on the "provision of plant or machinery for leasing in the course of a trade".

36. Even if there was such provision for leasing, the legislation (s384(6)(b) ICTA 1988) enabled relief against general income if it could be shown the appellant devoted "substantially the whole of his time" to carrying out the trade during the relevant year. However the Tribunal did not need to consider this issue as it was led to understand that the appellant conceded that even if it were accepted that he spent up to 20 hours a week on the yacht business this did not amount to "substantially the whole of his time" being spent on the yacht business given he was employed full-time for 35 hours per week with Jupiter International Group. If it had become necessary to express a view on that issue we would not have had any difficulty in reaching the conclusion that the appellant did not spend "substantially the whole of his time" on the yacht business given the amounts of time in issue and his full-time employment elsewhere.

37. It was not in contention that the yacht fell within "plant" for the purposes of s384 ICTA 1988 or that its provision was in the course of a trade. The question was whether the arrangements of the appellant's business amounted to provision of something other than provision of the yacht for leasing or whether, as the appellant argues they amount to provision of services which include the use of the yacht.

38. We were referred by HMRC to various definitions of bareboat charter and to HMRC's guidance on s384 ICTA 1988 and the analogy in there with a distinction between a contract for hire of machinery, where no operator is provided (provision for leasing) and a contract where an operator is provided (provision of a service). While this was helpful by way of background neither obviates the need of the Tribunal to look beyond labels and terms of art used by participants in the arrangements to the substance of the particular arrangements in this appeal and to consider these against the words of the relevant legislative provision.

39. The appellant's use of the term "bareboat charter" in the context of his particular arrangements reflects the fact that the charters did not come with a skipper. However that fact in itself does not in our view dispose of the issue of whether there was provision for leasing and it must be considered whether the other elements provided mean that the arrangements amount to something other than provision for leasing. Before doing that it is necessary to establish the nature of the relationships between the appellant, Blu Team and the charterers of the yacht.

Relationship between the appellant, Blu Team S.r.l and the clients chartering the yacht

40. For the sake of completeness we should mention that the appellant argued that he was in partnership with Blu Team in that they both shared the income and costs. Having considered the blank from agreement of Blu Team which the appellant confirmed was executed in identical form with himself, and the appellant's evidence as to how Blu Team dealt with him we have difficulty accepting this argument and in any case we do no think it would alter the need to consider the nature of the agreement between the appellant as partner and the end customer.

41. We are instead of the view that Blu Team acted as the appellant's agent in concluding charters of the yacht with the end customers. We do not think that Blu

Team can be viewed as chartering the yacht from the appellant on the basis of the payment arrangements, there being no agreed price over an agreed period. Rather Blu Team was remunerated through receiving a percentage of revenue from the charterers and a fixed fee of 180 Euro on a per charter basis for "technical management".

42. Further the fact that Blu Team would seek approval from the appellant on pricing matters and update him on bookings status does not indicate to us that Blu Team was the charterer.

43. The reference in the agreement to the grant of "sole management rights" is in our view consistent with Blu Team acting as an agent and the reference in the recital of the agreement to an intention to rent and charter is not the rent and charter by the appellant to Blu Team but in relation to the rent and charter of the yacht owned by the appellant to the customers.

Is what is being provided something other than provision for leasing?

44. It follows from above that the arrangements we must examine are those between the customers and the appellant through his agent Blu Team. The question is whether the nature and extent of what was being provided to the customers was something other than provision of the yacht for leasing.

45. The services provided by Blu Team in assisting with safe embarkation and debarkation, advice on weather and routes seem to us to be services which are ancillary to the hire of the yacht. Even if were to be case that these went beyond the services normally offered on a charter without a skipper they do not strike us as being services which customers would actively seek out as a point of distinction but would instead regard as being a welcome additional benefit to their yacht hire. It is also apparent that the services offered help to ensure the safekeeping and maintenance of the yacht and that they are services that it would be reasonable for the owner of a valuable asset to have in place. It is therefore not surprising that when something goes wrong with the yacht charter it would make sense to have Blu Team on hand to offer telephone assistance or if necessary send someone out to bring the yacht safely back and in tact.

46. The provision of marina berth and parking for customers are quite possibly elements which are not offered with other yacht hires but again these elements seem to us to be incidental to the yacht hire. They do not detract from the core of the arrangement being the customers' hire of the yacht. We cannot see how the location and ambience of the marina helps the appellant's case. Customers may very well narrow down the location of their desired yacht hire on the basis of where it is moored but what they are ultimately interested in and are paying for is we think the hire of the yacht.

47. In relation to the specific items the appellant referred us to it would be most surprising if certain safety related items such as life jackets, and life rafts were not routinely provided when providing a yacht for hire. Similarly the other items referred to are ones a person might reasonably expect to be provided when hiring a yacht.

48. We have considered the additional elements referred to by the appellant carefully but are not persuaded that whether they are viewed individually or collectively they mean that the arrangements can be viewed as provision of services which includes the use of a yacht rather than provision of the yacht for leasing. It is our view that the core of what is being provided to the customers is the lease of the yacht, the other elements are either inherent in the provision for leasing or ancillary to it.

49. The appellant is therefore unable to set the losses derived from the capital allowances on the yacht against his general income.

Discovery assessment

50. Discovery assessments were made on 24 March 2010 in relation to the years ended 5 April 2004, 2005 and 2006. HMRC contend the appellant had been negligent in that he did not make full disclosure of the business in which losses arose, or alternatively he had provided no information that would have drawn attention to the claim until his return for 2006/7.

51. The appellant had in each of the returns described the income from the business under the heading of "yacht charter". It was not until 22 September 2008 when HMRC enquired into the appellant's 2007 return that the appellant gave further detail about the yacht charter being a bareboat charter.

First condition for discovery assessment – was the under assessment attributable to the appellant's negligent conduct?

52. The onus is on HMRC to show the under assessment was attributable to the appellant's negligent conduct.

53. It turns out that having heard the evidence and arguments before us at the hearing the appellant was unable to persuade us that he was entitled to set the losses derived from capital allowance on the yacht against his general income. But, the fact his view of his entitlement proved to be wrong does not in our view mean that we must find that the resulting under-assessment was attributable to his negligent conduct. We must consider whether the appellant's conduct fell below what might be expected of a reasonable taxpayer. The appellant's description of his business as a "yacht charter" was certainly not an unreasonable one given what we heard about his business. With the exception of some of the arguments the appellant sought to make about the provision of safety equipment being a service, we do not think the appellant's view that the losses were not in respect of provision of plant for leasing because of various additional services which were being provided and the approach he took on the basis of that view was conduct which fell below what might be expected of a reasonable taxpayer.

54. Having considered the appellant's conduct we are not satisfied the appellant's conduct was negligent and therefore the first of the two alternative pre-conditions for a discovery assessment to be made is not fulfilled.

Second condition for discovery assessment – whether the officer could not have been reasonably expected to be aware of the under assessment, on the basis of information made available to him at the time when the enquiry window for the year of assessment was closed

55. Having reviewed the taxpayer's returns for the years of assessment under appeal and correspondence between HMRC and the appellant, we are satisfied that the HMRC officer could not have reasonably been expected to be aware of the under assessment until 22 September 2008 at the earliest. This is the point in time when following an enquiry into the appellant's 2006-7 return HMRC received a reply from the appellant which gave further detail about the yacht charter and mentioned it was a bareboat charter but that a skipper could be employed privately by the charterer. Up to that point HMRC would have been aware that the business was a yacht charter business but would not have had information available to them that a skipper was not provided. Yacht charters where a skipper was provided would on the face of it give rise to the entitlement to relief against general income which the appellant had made use of. Prior to receiving information that a skipper was not provided there was no information made available upon which HMRC might reasonably be expected to have known that the assessments for the years 2003-4, 2004-5 and 2005-6 were insufficient at the time the enquiry windows closed for those years. HMRC were entitled therefore to raise the discovery assessments on the basis of the second alternative pre-condition set out s29(5) TMA 1970.

Time limits for discovery assessment

56. The discovery assessments were made on 24 March 2010 and the time limit which applied, given our finding above that the appellant's conduct was not negligent, was the ordinary one set out in s34 TMA 1970. At the time the assessment was made the time limit for making an assessment to income tax was:

> "at any time not later than five years after the 31st January next following the year of assessment to which it relates".

57. The discovery assessments for 2004-5 and 2005-6 were in time. The discovery assessment for 2003-4 was not however in time. The time limit for assessing income tax in 2003-4 being 31 January 2010 which was 5 years after 31 January 2005. The appeal against the assessment for 2003-4 must therefore be allowed.

Conclusion

58. The appeals against the amendment to the appellant's self-assessment for 2006-7 and against the discovery assessments for 2004-5 and 2005-6 are dismissed. The appeal against the discovery assessment for 2003-4 is allowed on the grounds that it is out of time.

59. 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.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 19 June 2012