TC03896

Appeal numbers: TC/2013/7590, TC/2013/07591 & TC/2013/06560

Income Tax - Corporation Tax on capital gains - Whether a claim to add £360,000 as enhancement expenditure to the deductible costs of some let real properties was valid, so occasioning a loss rather than a gain on a part disposal of the properties - Whether there was private use of two company cars available to and utilised by one or both of the directors of the company - whether the capital gains return was fraudulent, and the absence of any disclosures in relation to the asserted car benefits were at the very least negligent - whether penalties were justified and whether they should be adjusted - Appeals substantially disallowed, but allowed in respect of one car

FIRST-TIER TRIBUNAL
TAX CHAMBER

FRANKLIN SWAIN
HELEN SWAIN
CLARISA LIMITED **Appellants**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

TRIBUNAL: JUDGE HOWARD M. NOWLAN
MR MICHAEL SHARP FCA

Sitting in public at Ashford House, Ashford, Kent on 29 July 2014

The Appellants were neither present nor represented

Philip Jones of HMRC on behalf of the Respondents

DECISION

Introduction

1. This was undoubtedly an extraordinary and very sad case.

2. The technical points and the facts at stake in these Appeals were all actually relatively simple. One related to a claim made by the Appellant company Clarisa Limited ("Clarisa"), both in its accounts and its tax return for year ending 31 May 2007 to have incurred additional expenditure of £360,000 in improving let properties owned by it, such that on making a part disposal of one of the units in the properties, Clarisa claimed to have incurred a loss rather than realised a gain for capital gains purposes. HMRC challenged the factual issue of whether the expenditure had been incurred and our decision is that Clarisa had failed to demonstrate that such expenditure had been incurred, and that the claim was indeed fraudulent. Accordingly we decide that HMRC was right to disallow the claimed expenditure, and to substitute a gain for the claimed loss, and right also to charge a penalty.

3. The other issue related to the ownership by Clarisa of two cars, and the claim by HMRC that both cars had been made available for private use by one or other, or possibly both, of the other Appellants, Mr. Franklin Swain ("Mr. Swain) and his separated or divorced wife, Mrs. Helen Swain ("Mrs. Swain). These claims led to income tax and NIC assessments in respect of the claimed benefits of private use. Mr. Swain had conducted the case in voluminous correspondence, and he had asserted that the cars were only ever used for business purposes, and that not only was private use prohibited, but it was also in fact non-existent. We reject this claim in relation to one of the cars, a Toyota Previa, and for a reason that we will expand on below we accept it with considerable hesitation in relation to the other vehicle, a Toyota Land Cruiser.

4. Whilst all the points at stake in relation to the two issues just mentioned were relatively simple, and it will be possible in this Decision to distill them into a few paragraphs, the extraordinary feature of this case is that the enquiry conducted by HMRC and the conduct of the negotiations (a rather inapt word for the exchanges of correspondence) occasioned an extremely bitter dispute between HMRC, and particularly the responsible officer, Mr. Smith, and Mr. Swain. One result of this was that we were given a reading day on the day before the hearing to read papers weighing 6.9 kilograms. The far more unfortunate result was that Mr. Swain was challenging Mr. Smith in relation to his competence, his impartiality, the allegation that he was racially prejudiced, the allegation that he was almost in some form of conspiracy with Mr. Swain's former accountants, the allegation that he must be remunerated on some form of bonus basis in which he would receive bonuses for maximising tax recoveries, and in relation to every matter that was ever under discussion. We appreciate that these matters are of very secondary relevance to us as the Tribunal. Since, however, Mr. Smith's conduct has already been the subject of several investigations, at the insistence of Mr. Swain, in all of which he has been exonerated, and since other investigations are, we were told, still pending, we consider that, having read the voluminous exchanges, and the bitter wrangling, and being fully conversant with the technical issues that Mr. Smith was dealing with, we should give our observation on what is technically an irrelevant issue.

5. Before commenting shortly on this matter, we should record that it is clear that Mr. Swain has been very unwell. We understand that he has had a heart attack and that surgery has left him with numerous problems. His failure to attend the hearing this morning,

accompanied by a request that we should deal with the Appeals in his absence since all his contentions were already clear, was also attributed to a further bout of ill health, and anxiety. We share everyone's sympathy for Mr. Swain's health problems, and accept that they may have led to an inability to deal with HMRC's enquiries in a balanced and sensible manner. They also led however to claims that Mr. Smith's conduct was responsible for Mr. Swain's heart attack, all his stress and numerous problems of ill health, and responsible also for the fact that Mr. Swain said that he had contemplated suicide. We did see a doctor's certificate and we obviously cannot comment on Mr. Swain's health problems that everyone, very much including HMRC, acknowledged and tried to accommodate.

6. Having said that, we simply must add that both of us unhesitatingly came to the conclusion that Mr. Smith's conduct had in every respect been impeccable, and that his handling of the whole enquiry, and the very difficult situation that he faced, had been skilful and restrained, and something of which both he and HMRC should be extremely proud. Should there be any future enquiries into Mr. Swain's complaints, all of which seem to us to be absolutely baseless, we would hope that those enquiries might simply be abandoned, or that at the very least our views should be taken into account. It is even less material for us to seek to blame Mr. Swain than it is to try to exonerate Mr. Smith, but Mr. Swain's conduct is the other side of this very sad affair, and our conclusion (without specifically describing his conduct in respects that we could) is that all his criticisms were absolutely and manifestly ridiculous.

The Capital Gains Issue

7. Whilst the correspondence was voluminous, it did actually fail to reveal many of the material facts, and had Mr. Swain attended the hearing, we might have been able to discover quite what the role of Clarisa had been at different times. It appeared that it purchased the relevant properties that it held in early 2007 from Mr. Swain in about 1995 for £75,000. At the time, Mr. and Mrs. Swain had not married, though in later periods it was Mrs. Swain who owned all the shares of Clarisa. It also appeared that at some time somebody (possibly Mrs. Swain) had operated a restaurant from one or all of the relevant properties, though if this had been the case, the restaurant business may have been conducted by her personally. Clarisa itself appeared not to have traded and, in early 2007, it was simply holding the various properties that had been transferred to it by Mr. Swain, and those were all let to a tenant or various tenants. We were given no information as to how many tenants there were, and whether the tenancies were short term or not, such that there was a regular need to re-let relevant parts of the total property.

8. In 2007 one of the units, representing roughly 25% of the total value, was sold. The property sold was known as 12 Pelham Arcade, Hastings, and properties 9 to 11 Pelham Arcade were retained. The capital gains calculation recorded gross proceeds of £90,000, diminished down to £69,238 by various costs claimed to be associated with the sale of the property. The original acquisition expenditure of £75,000 of all four properties or units was then said to have been enhanced by £360,000 expenditure, with further small amounts being claimed, and 25% of these costs were then claimed as further deductible costs in the calculation on the part disposal of 12 Pelham Arcade. As a result, it was claimed that the part disposal occasioned a capital loss of £41,175.

9. While HMRC did not dispute any of the other costs, they did question the deduction claimed for £360,000, of which £90,000 (25%) had been deducted in the calculation just

summarised. It emerged that this cost had first been recorded in the 2007 accounts, without having been mentioned in any earlier accounts. The accountants noted that they had prepared the accounts, without auditing them, on information provided by Mr. Swain and Mr. Swain had signed the accounts.

10. When asked by HMRC what expenditure of £360,000 had been incurred in 2007, Mr. Swain revealed that in fact no such expenditure had been incurred in 2007, but that following the purchase of the property 15 years earlier, when the property was asserted to have been derelict, some such expenditure of roughly £360,000 had been incurred. Mr. Swain also said, notwithstanding the point made in the last sentence of the previous paragraph, that he did not know why the accountant had inserted the deduction in the 2007 accounts.

11. Mr. Swain described the work that had allegedly been carried out 15 years ago, and said that it included waterproofing, painting, layout changes, moving the kitchen, replacing toilets and redecoration. To this, HMRC observed that several of those items might have been dealt with as revenue expenses that would have been set at the time against taxable rent, and that such items would in any event not be deductible in a capital gains computation. Beyond this, there was also no evidence of anything that supported the claim about the work allegedly undertaken.

12. There were then three worrying disclosures. Mr. Swain said that a mortgage had been registered against the property, which was presumably meant to indicate that borrowings had been incurred, and presumably the claim would have been that the money raised would have been applied in effecting the alterations and improvements. Mr. Smith was castigated for not having searched at the Land Registry to verify or dispute the claimed mortgage, though Mr. Swain also said in a manner that we might have been better able to understand had he attended the hearing, that money had never changed hands.

13. The second worrying feature was that Mr. Swain said that one of his former accountants (there appeared to have been a considerable number) had suggested that it was advantageous for tax purposes to register a mortgage, and accordingly he had instructed the then solicitor to register the mortgage. Whilst it was obviously for Mr. Swain to do the research and confirm what had actually happened, after considerable criticism from Mr. Swain for not having followed up what earlier advisers might have suggested and done, and why, Mr. Smith sought information from the indicated firms. They had either merged or the relevant individuals had left, and no information could be provided.

14. The final observation made by Mr. Swain in correspondence that further confirmed the doubt in relation to the legitimate case for deducting the £360,000 is that at one point he said that his earlier accountants would probably have claimed revenue deductions for much of the expenditure in the past, rather as HMRC had supposed.

15. Our decisions on these points are as follows:

1. It was absolutely clear that no expenditure remotely totalling £360,000 had been incurred in the 2007 period when it was first reflected in the accounts and then claimed without comment in the tax return;
2. Mr. Swain failed to account for how any other expenditure of a capital nature had been incurred at any earlier time; what the money had been spent on; which contractors had been used, and how the company had actually financed the

expenditure. Since in 2007 the rental income was only about £30,000 a year, it would have taken 12 years of gross income, assuming no other expenses and no salary payments to directors, to have financed either the expenditure or repayment of borrowings, of which there was anyway no evidence.

3. Since Mr. Swain had signed the 2007 accounts, and dealt with the tax returns on the basis of a completely unsubstantiated figure claimed for deductions in the 2007 accounts, we conclude that both this deduction claimed in the accounts and the tax return, and the continuance throughout the so-called negotiations that the deduction was legitimate, amount to a clearly fraudulent attempt to cancel a capital gain on the part disposal of the four properties, and to create a loss.

16. On the basis that we have concluded that the return was fraudulent, we conclude that the 25% penalty that HMRC has imposed is entirely justified. Were the amount of the penalty, and the mitigation or reduction to be in question, we consider, and we believe that HMRC probably consider that the reduction and mitigation has been excessive. In the light of Mr. Swain's ill health we will not disturb the quantum of the penalty, though we do clearly share the belief that the mitigation has been generous. While, in terms of "cooperation", HMRC had commented that Mr. Swain had always responded promptly to communications from HMRC, HMRC did manage to gloss over the point that Mr. Swain virtually never replied coherently to the particular point being put to him, but launched instead into a diatribe of abuse, criticising Mr. Smith for countless failings, such as asking the wrong questions and not bringing charges against earlier accountants and other such completely irrelevant matters.

The provision of the benefit of personal use of two vehicles, a Toyota Previa (i.e. a people carrier), and a Toyota Landcruiser (a 4X4 very sizeable rough terrain vehicle capable again of carrying a number of passengers)

17. By way of background, we understood that Mr. and Mrs. Swain had 6 children, the eldest being 15 in the year 2007. We were not told when Mr. and Mrs. Swain separated, but they were certainly living at different addresses by the date of the correspondence in relation to these Appeals (i.e. in 2012, 2013 and 2014). We were told that, at some stage, 4 of the children were living with Mr. Swain and 2 with Mrs. Swain, though it was also mentioned that the eldest (now presumably about 22) had left home some time ago. We are unclear whose car it was, but we were told that one or other of Mr. and Mrs. Swain owned a Toyota Celica, and that was the only car that either of them owned personally. A Celica is a small coupe, capable of carrying people in the back, but it would certainly be unsuitable as a car for 5 or 6 people.

18. Prior to 2007, Clarisa had not owned any cars, but it acquired 2 in that year. The first was the Toyota Previa, a people carrier. We were given few details of the purchase of this car. The other car, the Toyota Landcruiser, was acquired in a rather odd way. Clarisa was said to have made a "donation" to a judo club with which Mr. Swain had a significant connection. Quite what the donation consisted of we were not told, and we were not told whether it had any connection with the Landcruiser that at the time was owned by the judo club. Clarisa's accountants apparently said that the donation would not be accepted (from what standpoint, we do not know) unless Clarisa acquired the Landcruiser. It was not clear whether the donation was a disguised payment from the company that was meant to result in the Landcruiser being transferred directly to Mr. Swain, but we were also told that when the Landcruiser was transferred to Clarisa, the directors had to forego their salaries. Whether this was simply to fund the donation, or whether additional payments were made to the judo

club for the Landcruiser we were never told. Again, had Mr. Swain attended the hearing, he might have been able to explain the donation and the other steps in the acquisition of the Landcruiser. We believe that shortly after these events the judo club was disbanded.

19. HMRC suggested that both the Previa and the Landcruiser must have been made available to one or other or both of Mr. and Mrs. Swain. Mr. Swain asserted that they were exclusively used for business purposes. In response to questions from HMRC as to whether private use was prohibited, and whether indeed there was no private use of the cars, Mr. Swain said that there was a contract precluding private use, and that the insurance policies in relation to both cars prohibited private use. HMRC was eventually shown a contract, but that said that it was undated, and provided for no sanction, and Mr. Swain never produced any insurance documents.

20. Rather oddly, one question that HMRC never actually asked was what a company whose sole activity was to let out 4 and, after the sale, 3 properties to tenants (and we were never told whether the remaining 3 might have constituted one restaurant unit, with perhaps just one tenant) was ever going to use a car for business purposes for, let alone two cars, both of them seemingly odd business cars, but perfectly suitable cars for a family with 6 children.

21. Rather more relevantly, HMRC produced countless credit card slips evidencing the fact that almost on a weekly basis one of the cars had been to one of various supermarkets, both to be refuelled, and often to collect weekly shopping. Mr. Swain contended that the shopping was always required for business entertainment purposes. The business entertainment was allegedly always conducted at his house, and involved prospective tenants.

22. Our decision on the facts is that certainly in the case of the Previa, one or other of Mr. and Mrs. Swain must have had the private benefit of this company car. We were at a loss to understand why Clarisa would have required any car for business purposes, and the evidence about the weekly shopping, and the ludicrous claim that weekly shopping was always to provide food for business entertainment, with credit card slips in relation to family shopping mysteriously being lost, was just ridiculous.

23. Mr. Swain certainly claimed that the Landcruiser was solely used for business purposes, and it appeared that it was barely used at all. Why indeed it had been acquired, in the mysterious circumstances surrounding the donation to the judo club, we failed to understand, but we have decided to accept, with hesitation, the claim that the Landcruiser was used solely, and anyway to only a very modest degree, for business purposes. Had HMRC's representative been able to cross-examine Mr. Swain as to the private use of the Landcruiser, this might well have undermined the tentative conclusion that it was only used for business purposes. We also concede that our decision in relation to the Landcruiser is partially dictated by sympathy for Mr. Swain and his serious ill health, and by the observation that we are at a loss to understand what the Landcruiser was used for at all. It was tentatively mentioned by HMRC's representative during the hearing that both cars might in any event have now been sold.

24. The result of the conclusions thus reached is that the income tax and NIC assessments in relation to the Toyota Landcruiser and the accompanying penalties should all be discharged. The assessments and penalties in relation to the Previa are all confirmed. Insofar as carelessness is required to sustain the penalties, we conclude without hesitation that when the company clearly owned the Previa, when it must have been made available for

private use by one or both of the directors, and no return of any sort was made in relation to the resultant private benefits, this was careless at the very least. The contentions that were advanced in an effort to undermine the assessments simply constituted lies since it was preposterous to suppose that the Previa was used for business purposes at all, and yet more unbelievable to suggest that every shopping trip was required to purchase weekly provisions for business entertainment. Again, in terms of quantifying the penalties, we conclude that HMRC had in any event been over-generous in mitigating the penalties, but again we choose not to disturb the penalty in relation to the Previa, i.e. we will not increase it.

Overall conclusions

25. We accordingly confirm HMRC's disallowance of the claimed expenditure of £360,000 (a conclusion that we assume will be taken into account if and when further disposals are made), and we confirm the accompanying penalty. We confirm the assessments to income tax and NIC contributions in relation to the private use of the Previa, and we discharge the assessment (and of course it then follows, the penalties) in relation to the Landcruiser.

26. This decision accordingly makes a substantial gesture to Mr. Swain, and indeed one that had further facts emerged in relation to the Landcruiser, we might have felt unable to make. We acknowledge that his ill health, and his mental disturbance, are not grounds on which we are entitled to reduce assessments, nor indeed can we reduce assessments on account of any supposition that Mr. Swain may have been badly advised in certain respects. We do however hope that, while Mr. Swain may very well be furious that his whole conduct and his various arguments have not all been vindicated, he should appreciate that we are probably being over-generous to him, out of sympathy.

27. We reiterate that Mr. Smith, and a Senior Complaints Officer of HMRC, Julie Southway, who appeared to have the role and the unenviable task of spraying oil on troubled waters, are both to be complimented again for impeccable conduct of which HMRC should be proud, and that we were exceptionally impressed to observe. We make it clear that the views expressed throughout this Decision are the views of us both.

Right of Appeal

28. 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.

JUDGE HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASED: 5 August 2014