[2021] UKFTT 311 (TC)

TC08253

INCOME TAX and PENALTIES – self-assessment return – enquiry and closure notice – s 34 of ITTOIA 2005 – deductibility of payments to father – lack of business records as required by s 12B TMA – taxpayer's object in incurring expenditure – whether 'wholly and exclusively' for the purpose of trade – Schedule 41 FA 2008 and Schedule 24 FA 2007 – failure to notify liability and inaccuracy – interaction of penalties – whether deliberate – ***appeal dismissed***

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/06887

BETWEEN

DAVID CATION **Appellant**

-and-

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

TRIBUNAL: JUDGE HEIDI POON
IAN SHEARER

Sitting in public at Eagle Building, Glasgow, on 18 November 2019, and on 3 and 4 December 2020 on the remote platform hosted by the Video Hearings Service of HMCTS

Having considered parties' responses in relation to the format of the resumed hearing, Directions were issued on 2 October 2020 for the hearing to take place by video link on the basis that it was not in the public interest during the pandemic to hold a face to face hearing. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Gary Brothers of Independent Tax and Forensic Services LLP for the Appellant

Matthew Mason and Michelle Beveridge, Litigators of HM Revenue and Customs' Solicitor's Office for the Respondents

DECISION

INTRODUCTION

1. This is an appeal by David Cation ('the appellant' or 'Mr Cation') against the decisions by the respondents ('HMRC') in relation to the following matters.

(1) For the tax year 2014-15:

(a) The closure notice assessment for an income tax liability of £14,880.94;

(b) A penalty for inaccuracy in the Self-Assessment ('SA') return for £7,812.49.

(2) For the tax year 2013-14:

(a) A penalty for failure to notify ('FTN') in the sum of £4,677.96;

(b) A penalty for inaccuracy in the SA return in the sum of £482.14.

2. By closure notice dated 25 June 2018, HMRC disallowed a total of £30,000 claimed as deductible expense against the appellant's self-employment income. The payment was said to be for the services provided by the appellant's father. The issues for determination in relation to the year 2014-15 are:

(1) Whether the £30,000 expense claimed in the appellant's 2014-15 return was 'wholly and exclusively' for the purpose of his trade;

(2) If not, then whether the expense claim was a deliberate inaccuracy.

3. In relation to the penalty assessments for 2013-14, the issues for determination are:

(1) Whether the failure to notify a new income tax liability was a deliberate act; and

(2) Whether there was a deliberate inaccuracy in the return to avoid Class IV NIC.

LEGISLATION AND CASE LAW

4. The provisions under the Taxes Management Act 1970 ('TMA') relevant to the case are:

(a) Section 7 for Notice of Liability to Income Tax and Capital Gains Tax;

(b) Section 9A for Notice of Enquiry;

(c) Section 12B for Records to be kept for purposes of returns;

(d) Section 28A for Completion of enquiry into personal return;

(e) Section 29 for Assessment where loss of tax discovered;

(f) Section 34 for Ordinary time limit of 4 years;

(g) Section 36 for Loss of tax brought about carelessly or deliberately;

(h) Section 50(6) which provides that a closure notice assessment shall stand good unless the taxpayer discharges the burden that he has been overcharged.

5. The penalties for inaccuracy are assessed under the terms of Schedule 24 Finance Act 2007 ('Sch 24'); the FTN penalty is pursuant to Schedule 41 Finance Act 2008 ('Sch 41').

6. In relation to the deductibility of the disputed expense, section 34 of the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA') provides as follows:

> **34 Expenses not wholly and exclusively for trade and unconnected losses**
>
> (1) In calculating the profits of a trade, no deduction is allowed for –
> (a) expenses not incurred wholly and exclusively for the purposes of the trade, or

(b) losses not connected with or arising out of the trade.

(2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade.

7. Parties referred to the following authorities in their submissions:

(1) *Cannon v HMRC* [2017] UKFTT 859 (TC) ('*Cannon*')
(2) *Clynes v HMRC* [2016] UKFTT 369 (TC) ('*Clynes*')
(3) *Mallalieu v Drummond* [1983] STC 665 ('*Mallalieu*')
(4) *Copeman v Flood (William) and Sons Ltd* [1941] 1 KB 202 ('*Copeman*')
(5) *Bentley, Stokes and Lowless v Beeson* [1952] 33 TC 491 ('*Bentley and Stokes*')
(6) *Robinson v Scott Bader Co Ltd* [1981] 54 TC757 ('*Scott Bader*')
(7) *Vodafone Cellular Ltd & Ors v Shaw* [1997] 69 TC 376 ('*Vodafone v Shaw*')

THE WITNESSES

8. In the first diet of hearing in November 2019, we heard the evidence of Officer Lee Sutherland and then Mr Peter Cation. The appellant was at the hearing venue on the day, but was excluded from the hearing during the evidence sessions of the first two witnesses.

9. Officer Sutherland opened the enquiry into the appellant's tax return for 2014-15 and was the decision maker for the matters under appeal. Officer Sutherland's oral evidence was closely corroborated by the correspondence between the parties in the course of the enquiry. His evidence was led by Ms Beveridge, and he was cross-examined by Mr Brothers.We find Officer Sutherland a credible witness and accept his evidence as to matters of fact.

10. Mr Peter Cation is the father of the appellant, and he gave evidence in relation to the role he played in the appellant's business, and the circumstances that led to the payments by his son totalling £30,000. We find Peter Cation to be straightforward and mostly honest, not least, as his evidence at times does not really assist the case that the appellant is seeking to advance.

11. Mr David Cation's evidence was given in the second diet on the video hearing platform. Whilst much of his evidence was helpful towards understanding his business and what had taken place, we find that on some aspects his oral testimony presented an account of events framed in hindsight with the legal issues in mind. In some such areas, we have accorded more weight to primary facts ascertainable from contemporaneous documents, and have based our factual findings on inferences drawn from the documentary evidence, and known or probable facts. It is not to say that Mr Cation's oral testimony in these areas serves no useful purpose; we consider its value lies largely in the opportunity which cross-examination afforded by subjecting the documentary evidence to critical scrutiny, and for the Tribunal to gauge the personality, acumen, and intentions of the witness.

THE FACTS

Background to the appellant's business

12. David Cation has been working in construction since 1983, and qualified as a chartered surveyor in 1990. He worked as an employee in a sale role for companies until 2016. His last two employers were Systems Aluminium Ltd from 2002 to 2011, and from May 2011 to August 2016, Charles Henshaw & Sons Ltd ('Henshaw'), which he described as at the 'top end' of the construction industry, dealing with multi-million pound contracts in major city-centre projects.

13. In his employment with Henshaw, Mr Cation worked initially as a Pre-Contract Director in the Estimating Department, and was latterly promoted to Sales Director. His responsibilities included: (a) maintaining contacts in Scotland whilst liasing with the Saels Director (latterly Deputy Manager) based at Liverpool, who covered the M6 Corridor from Leeds up to Newcastle; (b) estimating function of all projects which came in for pricing; (c) profiling of contractors and clients according to the types of projects; (d) negotiating contracts with multi-national companies; (e) carrying out due diligence on the bids submitted. He lives in Glasgow, and the job with Henshaw involved commuting to Edinburgh, and occasionally his evenings were taken up by entertaining clients or networking at rugby or football matches, ceilidh or charity functions.

14. In and around 2007-08 Mr Cation started exploring the prospect of running his own business by attending evening courses provided by Scottish Enterprise. The economic downturn of 2008-09 meant no progress was made until 2012, when Glassal Limited ('Glassal') was formed to be a specialist supplier in bespoke glazing systems, and to provide installation service of the glazing systems as an integral architectural structure of the buildings. Glassal was to operate in a different niche market from Henshaw, and the start-up of Glassal was done, according to Mr Cation, with the knowledge and encouragement of Henshaw.

15. Glassal was incorporated on 5 March 2012, and Mr Cation is an equal shareholder with a former colleague, Mr Steven Douglas. In the initial years after Glassal was formed, Mr Cation was still being full-time employed with Henshaw. Mr Cation provided his service to Glassal in his personal capacity, trading as 'DC Consult', and DC Consult would render invoices to Glassal for payment of his service.

16. For the tax year 2014-15, DC Consult rendered 12 monthly invoices to Glassal at £2,500 each, plus an additional invoice dated 15 January 2015 for £40,000 for 'services for 2014 as agreed', bringing the total turnover to £70,000. In terms of expenses claimed as deductible against the £70,000 turnover, the largest component was a sum of £30,000 was said to have been paid to Mr Cation's father, Peter Cation. The deductibility of the £30,000 as an expense is the matter in dispute.

Closure notice amendments to 2014-15 return

17. The course of correspondence between parties that led to the closure notice disallowing the £30,000 payment as a deductible expense is as follows.

(1) On 14 January 2016, the appellant filed an SA return for the year of assessment 2014-15, reporting an estimated turnover of £70,000 and business expenses of £31,233.

(2) On 10 January 2017, HMRC Officer Lee Sutherland opened an enquiry into the return under s 9A TMA.

(3) On 9 February 2017, the appellant's agent John Griffiths Business Advisors ('JGBA') replied to HMRC's queries enclosing, among other recrods, a hand-written invoice by Peter Cation, which bears the date of 1 March 2015 and the description of '*Sales and Marketing Support As Agreed*'. The hand-written invoice has a pre-numbering of 37 and a typed heading in capital as 'Peter A Cation', followed by an address; a former VAT registration number was blocked out; the invoice was addressed to DC Consult.

(4) The letter also confirmed that that the income of £30,000 had been reported by Peter Cation who is self-employed. Documents such as bank account statements for the year to April 2015, a selection of invoices, purchase receipts and bills were provided.

(5) On 19 April 2017, JGBA wrote in reply to HMRC's letter of 4 April 2017 in relation to the £30,000 payment in the following terms:

'1. Peter Cation acted as a mentor and advisor to David Cation helping specifically with the following.

a. Set up of self-employment.
b. Following up on quotations.
c. Chasing potential customers.
d. Making comparison and reporting back.

2. The work covered a three year period from August 2011 to March 2014.

3. The fee was greed on the basis of the above.

4. Payments were made electronically and I enclose extracted bank statements showing the following payments.

a. 3rd July 2014 £750.
b. 6th August 2014 £750.
c. 4th November 2014 £750.
d. 2nd December 2014 £750.
e. 26th February 2016 £6,000.
f. 7th March 2016 £1,000.
g. 25th January 2017 £10,000.
h. 10th February 2017 £10,000.'

(6) On 27 April 2017, Officer Sutherland wrote again to query the role of Peter Cation in the business by highlighting the discrepancies in the timing of the payments being made and the expense claim: £3,000 in 2014-15; £7,000 in 2015-16; and £20,000 in 2016-17, and the £30,000 being claimed for deduction in the SA return for 2014-15.

(7) On 26 May 2017, JGBA responded to the queries with the salient aspects being:

(a) Peter Cation's role was 'advisory and mentoring', and 'non-technical regarding the projects' by identifying potential work when scouting and passing this information to David Cation; by following up on quotations issued and reporting back on price comparisons with competitors for David Cation to make final commercial decisions.

(b) Peter Cation's 'advice and mentorship was required because David was embarking on a path out of the employment into self-employment' and his father had 'many years of experience'; that it was 'a father-son relationship and meetings and conversations were regular and casual'.

(c) Peter Cation 'did not receive half of David's fees; he received 33.3% in the period from 2011 to March 2015. The remainder of David's share of Glassal's profits was retained by Glassal and funds future projects and developments.'

(d) Peter Cation issued the invoice for the £30,000 during the year 2014-15 for the work undertaken from mid-2011 until 2014-15, because:

> 'Peter did not invoice for his services in this period and reached an agreement with his son that he would pay for the services that Peter provided (he was effectively acting as a sub-contractor to David) only once the company was successfully established.'

(e) There is no formal agreement; work was undertaken on a job-to-job basis as need arose; work is cyclical, which is normal in the construction industry; they simply agreed that £30,000 was a fair value for the work undertaken over the almost 4-year period.

(8) By letter dated 21 June 2017, Officer Sutherland stated that:

(a) HMRC did not accept that the expenses of £30,000 were 'genuinely incurred wholly and exclusively for the purposes of any apparent trade undertaken by David Cation'; or that Peter Cation was acting as a sub-contractor. They noted that the hand-written invoice of 1 March 2015 did not include include any details or dates of the services provided; and requested: (i) documents for quantifying the amounts relating to each particular tax year; (ii) the date of commencement of Mr David Cation's self-employment.

(b) HMRC queried whether 'the payments purporting to be for consultancy services provided by DC Consult were [not] in fact a distribution of the profits of Glassal Limited', given what JGBA had stated that 'the "remainder of David's share of Glassal's profits was retained by Glassal'.

(c) In relation to the explanation in the timing of payment to Peter Cation 'would only be made once the company was successfully established', HMRC queried why that should be the case: 'if David Cation was undertaking a genuine consultancy and Peter Cation was a genuine sub-contractor, then the successful establishment of the company would not have been relevant to those sole trades.

(d) The letter asked for a full response to the queries by 28 July 2017.

18. On 14 July 2017, an Information Notice under Schedule 36 to the Finance Act 2017 was issued, covering all aspects of queries as related in the letter of 21 June 2017, in the absence of any response received although before the said date of 28 July 2017. JGBA considered the service of the Sch 36 Notice to be an 'escalation' of the enquiry, and referred the enquiry to Independent Tax and Forensic Services LLP ('ITFS').

19. Correspondence started in September 2017 between HMRC and ITFS, and after a meeting on 15 January 2018 between Officer Sutherland, and Mr Brothers and Mr Nick Davies of ITFS, Mr Sutherland worte on 5 February 2018 setting out the 'Action Points' for response, namely:

(1) To specify a date of commencement of DC Consult as a business;

(2) To provide details of quotations, and sites 'scouted' by David Cation trading as DC Consult on behalf of Glassal and any prospective clients;

(3) To provide full details and evidence in respect of the duties and work undertaken by Peter Cation for the £30,000 payment and documentation related thereto.

20. By letter dated 9 March 2018, ITFS responded to HMRC's 'Action Points' as follows:

(1) The business model of Glassal was to become a subcontractor to a main contractor for the provision and installation of commercial glazing systems on developments; Glassal would follow specifications obtained by its suppliers for particular types of glazing systems specified for a development project in which up to six main contractors might tender for the development.

(2) Glassal would in turn submit quotes to the main contractors in the hope of winning installation work from the contractors which were successful in tender.

(3) David Cation prepared the technical and commercial offers to undertake work, and his father followed up the submissions.

(4) Apart from general business mentoring, Peter Cation's 'services would be used to identify and develop contacts within main contractors once tenders had been submitted'; and 'when multiple main contractors had quoted for a particular development', Peter

Cation 'would approach his contacts' to ascertain the winner of the contract 'to enable Glassal's quote to be followed up'.

(5) The statements made on behalf of Mr Cation in this reply are:

(a) That David Cation's self-employment commenced in March 2012, coterminous with the establishment of Glassal.

(b) David Cation 'subcontracted business development work to his father, who also undertook other consultancy work for him including the provision of advice on business formation and general business mentoring.'

(c) Peter Cation was 'effectively engaged on the basis of a "success fee" – if his endeavours were unsuccessful he would not be paid.'

(d) Peter Cation made a payment of £7,265.07 on 3 February 2017 in relation to his 2015-16 self-assessment liability; bank statements were enclosed showing Peter Cation receiving two payments of £10,000 each from David Cation between 15 January 2017 and 15 February 2017.

21. On 13 April 2018, Officer Sutherland issued his 'View of the Matter' letter, which states:

(1) David Cation never confirmed the date of his self-employment commencing and there was a failure to notify liability in respect of the tax year 2013-14. The SA return for 2013-14 was submitted in June 2017 after the opening of the enquiry into 2014-15.

(2) There was no claim of expenses for 2013-14, but JGBA had advised that the payments to Peter Cation related to services provided from August 2011 to March 2014.

(3) No evidence was provided to suggest that a trade was being conducted by David Cation or that Peter Cation provided the services that merited the £30,000 payment. The single invoice dated 1 March 2015 gave no detailed account of the services provided. If there was a *bona fide* commercial agreement between the parties, particulars to evidence the services provided at a commercial rate should have been available.

(4) HMRC considered the monthly payment of £2,500 by Glassal to David Cation to be some form of interim distribution, or remuneration for an office held, rather than genuine self-employment. From JGBA's explanations (ie 'Peter didn't receive half of David's fee; he received 33.3% in the period from 2011 to March 2015'), the payments from Glassal to David Cation would appear to be part of the allocation of his profit share from that company. David Cation is now a director of Glassal, and fees appear to have ceased at some point prior to April 2016.

(5) HMRC contend that the payments to Peter Cation were not in fact expenses incurred in earning the profits of any trade, but merely an application or redistribution of David Cation's profit share from Glassal.

The Review Conclusion

22. On 3 May 2018, ITFS replied by requesting an independent review, which was procedurally premature since HMRC had not formally closed the enquiry. In response, Officer Sutherland issued on 25 June 2018 the closure notice under s 28A (1B) and (2) of TMA to disallow the £30,000 as deductible, giving rise to additional income tax payable of £14,880.94. On 27 July 2018, ITFS requested a review of the closure notice, the slight delay was caused by the closure notice being sent to JGBA in the first place.

23. On 4 October 2018, the Review Conclusion upheld the closure notice, for the reason that there was insufficient evidence to satisfy HMRC that the payments made to Peter Cation were

'wholly and exclusively' for the purposes of the trade of DC Consult. In particular, the review conclusion highlighted that:

(1) The enquiry was opened on 10 January 2017, and David Cation transferred two sums of £10,000 into Peter Cation's account on 26 January 2017 and 10 February 2017.

(2) If the agreement to pay Peter Cation was on the basis of his endeavours being successful, and the expense was claimed for the year 2014-15, then the appellant must have thought his father's work had been successful enough to generate a payment of £30,000 when the return was submitted in January 2016.

(3) It is unclear to HMRC what happened in the 15 days after the opening of enquiry that prompted the appellant to pay 'a large chunk of the payment [he] had claimed as an expense 2 years earlier.'

The penalty assessments

Schedule 24 penalty in relation to 2014-15 return

24. In relation to 2014-15, the Sch 24 penalty in the sum of £7,812.49 was assessed at 52.5% of the potential lost revenue ('PLR') of £14,880.94, being the sum of additional tax payable following the closure notice amendments. The Penalty Explanation schedule issued on 3 August 2018 set out the conclusion reached by HMRC on the penalty percentage as follows:

(1) A 'deliberate' inaccuracy by including an expense to a family member which is not 'wholly and exclusively for the use in the sole trade consultancy business'; the disclosure was 'prompted' by the enquiry;

(2) The penalty percentage for deliberate and prompted inaccuracy is set at 70%;

(3) A total reduction of 50% for telling, helping and giving was applied to the penalty range of 35% (being the maximum 70% and minimum 35%) to give an overall reduction of 17.5% against the maximum of 70% to arrive at 52.5%.

Schedule 24 penalty in relation to 2013-14 return

25. The Sch 24 penalty for 2013-14 was assessed at 43.75%, after applying a total reduction of 75% to the penalty range of 35% (70% maximum and 35% minimum). Officer Sutherland concluded that the declaration of £20,000 was prompted by the enquiry into the 2014-15 return, and the error was deliberate by including it as 'Other Income' to remove Class IV NIC liability.

26. Additional evidence was lodged by HMRC in response to the letter dated 9 August 2018, in which ITFS stated that Mr Cation was 'unrepresented at the time the return was completed and does not understand the intricacies of the tax system'; that he had 'erroneously' entered the income 'in the wrong box due to his lack of understanding of taxation', and submitted that this was 'at worst' being 'careless', and asked for a suspension of the penalty.

27. At the second diet of hearing, HMRC produced additional evidence in the form of SA Notes on Mr Cation's records, and we note the following entries relevant to this appeal:

(1) *12/11/2015* – New agent details received; (this being JGBA);

(2) *01/06/2016* – Return for 2014-15 corrected for HICBC ('High Income Child Benefit Charge');

(3) *10/01/2017* – No repayment signal set – taxpayer selected for a s 9A enquiry and registered on SA record;

(4) *07/03/2017* – Taxpayer requesting return as he needs to declare 20k; letter issued with P60 information and return issued filing date 7/6/17;

(5) *21/06/2017* – Return 2013-14 unlogged/ sent back to taxpayer as indicated in receipt of child benefit but amount paid not shown (HICBC would be due); return due date deferred to 13 July 2017.

28. In relation to the 2013-14 SA return, a discovery assessment was raised on 22 June 2018. No appeal has been lodged against the assessment, and the discovery assessment itself is not a matter for the Tribunal. The quantum of the assessment relates to the Class IV NIC due on the £20,000 received from Glassal, which was declared as 'Other Income' in the return, while HMRC consider that it should have been declared as self-employment income and subject to Class IV NIC.

29. Although the discovery assessment is not under appeal, the circumstances surrounding the filing of the 2013-14 return are relevant to the consideration of the FTN and inaccuracy penalties. Mr Cation had requested a paper return on 7 March 2017, and the date of the paper return for 2013-14 being filed is established to be in June 2017, as the SA Notes recorded the paper return being sent back to Mr Cation on 21 June 2017 for correction, as the amount of child benefit received by the household was omitted for calculating HICBC.

30. Mr Mason referred to 12 November 2015 as the 'benchmark date', when the authority to appoint JGBA as agent was registered on Mr Cation's SA records. Questions were put to Mr Cation that the filing of 2013-14 return in June 2017 was prompted by the opening of enquiry into the 2014-15 return, and that it was a deliberate inaccuracy to save Class IV NIC by declaring the £20,000 income as 'Freelance Income' when he should have known that it should be returned on the self-employment pages, especially given that the £70,000 which had been declared as self-employment income in the 2014-15 return.

31. On 21 June 2017, HMRC sent back Mr Cation's paper return for him to include the Child Benefit figure. Instead of amending the paper return for re-submission, it would appear that Mr Cation had chosen to file his 2013-14 return online on 26 June 2017. It was put to Mr Cation that he was afforded a second opportunity to correct the £20,000 as self-employment income, and yet he chose not to do so. He disagreed that his error had been in any way deliberate.

Schedule 41 penalty in relation to 2013-14

32. The FTN penalty under Sch 41 was assessed as 'deliberate' and 'prompted', and the reasons as given in the Penalty Explanation letter dated 3 August 2018 are:

(1) HMRC was not informed of a start date of the self-employment, as such no SA return was completed as would have been required for 2013-14;

(2) It was after the enquiry was opened into 2014-15 that an additional £20,000 was disclosed as income;

(3) 'It stands to reason that [the appellant] must have known this value should have been declared sooner' but no steps were taken to ensure that it was prior to the enquiry.

33. The quantification of the FTN penalty was at 42% of the additional tax liability of £11,138.25, (of which £1,102.05 was attributable to Class IV NIC upon re-classifying the income under self-employment). A total reduction of 80% was applied to the penalty range (of 35%) to bring the maximum 70% to 42%.

34. Pursuant to Tribunal's Directions issued after the first diet, HMRC have considered the interaction between the two penalties assessed for 2013-14. The alternative quantifications are:

(1) Scenario 1 : Sch 41 penalty stands at £4,677.96 (being 42% of PLR of £11,138.25), and the Sch 24 penalty reduced to nil;

(2) Scenario 2: Sch 41 penalty is revised to £4,215.20 (being 42% of PLR £10,036.20) and Sch 24 penalty stands at £482.14 (being 43.75% of PLR £1,105.02); the total of the two penalties is £4,697.34.

WITNESS EVIDENCE

35. In rebuttal to the fact highlighted in the 'View of Matter' letter that no evidence had been provided to suggest that there was a trade being conducted by Peter Cation, ITFS averred in its letter dated 3 May 2018 that the absence of what Officer Sutherland considered as 'hard evidence' did not preclude evidence existing. To that end, the appellant seemed to have relied on the testimonies of Peter and David Cation. For this reason, their witness evidence is summarised here for us to base our findings of fact.

Peter Cation's evidence

36. Peter Cation worked as a self-employed sales representative between 1984 to 2012 when he retired. His clients included manufacturers / importers (e.g. Palmer Agencies Belfast awhich specialised in party outfits, and INDE Plastik Germany, which produced polystyrene containers for wholesalers, cash and carry, and fish and chip boxes, etc); and two 'fancy dress shops' for party outfits. He would visit prospective customers (e.g. fish-and-chip takeaway outlets, shops stocking Halloween dress outfits) to promote the products of the suppliers he was representing. He was paid a 'commission' by the suppliers, based on the sale value procured for the suppliers, which was around £250,000 to £300,000 per annum, and the commission was normally at 10% of the value of sale. His fee was calculated based on the copy inovices collated, and would hten send his commission statement; he relied on an accountant to help with any claim of expenses and self-assessment return.

37. In relation to the role played by Peter Cation for his son from 2012 onwards, a three-page document was produced with the heading *Enquiry Register of Glassal Limited* with data in relation to enquiries received between 15 February 2012 and 9 December 2015, tabulated in nine columns under the headings: (i) *Reference* (being the date and year of the enquiry in numerals); (ii) *Project name* (as advised by architects or clients); (iii) *Location* (of the project); (iv) *Value* (as quoted by Glassal); (v) *Date* (of Glassal's tender); (vi) *Customer* (name of); (vii) *Contact* (personal name); (viii) *Telephone number* (of the personal contact); (ix) *Product* (glazing systems of the enquiry; e.g. Canopy Glazing, Curtain Wall, Door Screen).

38. HMRC took issue with the fact that the Register was not produced in the course of the enquiry, and that it was only first sighted by HMRC on 24 June 2019 (when included in the listed documents for the hearing). When asked about the Register, Peter Cation displayed little to no knowledge of it, and said it was probably prepared by David Cation. When asked why the Register was headed Glassal Ltd, he replied: 'this is one of [David's] companies'.

39. Peter Cation's replies to various questions put to him in relation to the services for which he was paid £30,000 were as follows.

(1) When scouting for prospective customers, that he would introduce himself (for example, going into a building site) and hand in a business card, and say that he was 'working for [his] son'; and ask to be put to 'the right person'. He said he would sometimes recommend prospects to his son to follow up, and described examples of some of the sites he visited in Glasgow, and 'maybe' Edinburgh, Aberdeen.

(2) He said Glassal had the USP (unique selling point) of being able to take on 'small jobs' for 'glass fronted products'; but his sales prospects 'don't ask me of prices for I have no idea'; that he had 'no personal contact with the prospective customers'; and he confirmed that he did not keep any record of the these potential customers.

(3) When asked what he did for his son, he said there would be enquiries coming in from Glassal, he would ask those enquiring what it was that the customers wanted; how they heard about Glassal. Sometimes they would say that 'the name had been bandied about in the business'. He said when an estimate was given, but 'nothing came of it', and he would be 'sometimes' following up the estimate, and reporting back to his son.

(4) When asked what he meant by 'sometimes', he said 'two-three-four calls'. When asked 'how often' he would be doing this reporting back to his son, he said 'occasionally'; he clarified that he 'would not have the estimate in front of [him]' when he made these follow-up calls; that his role was 'non-technical' and that he did not know the 'ins and outs of it'.

(5) The witness statement refers to his involvement as being 'at anything up to 2 days per week', and when asked whether that was an average, he replied: 'Generally a lot less than that.'

(6) When asked what was a day's work, he said it depended how many calls he had to make, but records of these were not kept. He said, 'If he [David] was busy, I was busy'. Sometimes, he would speak to people 'off my own bat'; at other times, leads would come from his son. However, 'I wasn't doing this for money'. Success would be measured when his sone told him of a confirmed order, and his son kept the records of these.

(7) He was questioned about the general business mentoring and advice he had given his sone since 2011 about starting up in self-employment, he said he guided his son 'in the way any father would'. When asked if he was paid for this, he replied 'not there and then', but added that the advice on self-employment was 'freely given from father to son'. He said he did not give his son advice on tax and /or self-assessment.

(8) When asked what mentoring advice on trading medium he gave his son, Peter Cation said that from his own experience, he was aware of the problems in going into partnership with another person because 'you don't really know your partner', and related how he narrowly averted going into partnership with someone who would have left him in a bad situation, and had advised his son against going into partnership in business.

(9) When asked what the difference is between a limited company and a sole-trade, he said a company is 'governed by more rules'.

(10) When asked what David Cation said to 'convince' him of the trading medium he chose, the reply was: 'He didn't need to convince me. He is a grown man; he made up his own mind.'

(11) When asked about the hand-written invoice, he said David Cation asked for an invoice, and he used his invoice book (from his former trade as a sale representative) and wrote him an invoice. He was equivocal about the exact timing of the request for the invoice, other than to say that it came to be dated as '*1 March*' as 'it was then I did it', but without actually stating *the year* in which it happened.

(12) His witness statement states: 'It was therefore my role to undertake the follow up work on David's behalf on a consultancy basis.' However, when asked whether he had ever done 'consultancy work', he replied with a definite 'No', and confirmed that he had no other consultancy client.

(13) When asked if he considered himself a consultant to his son, he replied: 'I was really a scout, not a consultant'; it was 'a piece of fun, to help him out; did not feel it was a piece of consultancy work' but 'covering some of his time'; 'helping him out, not seeking payment; not the way I understand it'.

(14) When asked what discussion he had in quantifying the £30,000 payment, he said it was 'based on, as and when [David Cation] can afford it', and that he would not have known what consultancy fee would be typical for the kind of work done; he confirmed he did not know his son's turnover if fees would be calculated on a commission basis.

(15) When asked why there was a gap in issuing the invoice, he said there was 'o reason really'. When asked whether there was any reason for the actual payments being much later than the supposed timing of the service rendered for up to March 2015, he said his son could not afford to pay him until he did.

The 2015-16 return and amendments

40. The questioning turned to the inclusion of £30,000 in Peter Cation's return for the year 2015-16. Peter Cation said he had asked his accountant in January 2017, whether the payment was a 'gift' or a 'salary' (his choice of words). He was advised that it was a 'salary' to be 'declared' and it was then included in the return for 2015-16. When asked if the income was declared as 'commission', he replied it was 'self-employment income', and confirmed he understood that it would be included in the separate Self-Employment ('SE') pages.

41. In cross-examination, HMRC referred to the original return filed and the subsequent amendment made to Peter Cation's 2015-16 SA return (these being third-party documents were not produced to the Tribunal). No challenge was made as regards the factual contents of the return and the amendments put to Peter Cation during cross-examination, which include:

(1) The £30,000 was not declared in the original return submitted in mid-2016;

(2) On 23 January 2017, an amendment to the submitted return was made;

(3) Under 'Other Income' £30,000 was entered as 'Retainment payment', that being the amendment to Peter Cation's 2015-16 return;

(4) On 3 February 2017, the sum of £7,265.07 was paid as the additional income tax liability following the amendment to include £30,000 as 'Other income';

(5) No income of £30,000 was declared in the 2014-15 return despite the hand-written invoice being dated 1 March 2015. When asked whether he declared his income on an 'Accrual' or 'Cash' basis, he replied that he paid his tax 'as soon as I got it from the accountant'.

42. In reply to questions put to him in re-examination, Peter Cation described David Cation as 'dealing in hundreds of thousands' while he was 'dealing in tens of thousands'; he assented to the description that David Cation was operating 'on a totally different scale from yours'.

David Cation's evidence

43. Mr Cation left his employment with Henshaw in August 2016, and was appointed director of Glassal in March 2017 (but he only became a PAYE employee of Glassal in March/April of 2019). In January 2016, he set up his own new consultancy company – Vincenti Projects Limited, which is still running, and was likewise its PAYE employee. Vicenti would appear to replace DC Consult as the trading medium for Mr Cation. He explained that if something were to happen to Glassal, he would still have his own company. The incorporation of Vicenti was the result of his 'risk assessment' of his consultancy business, that if a complaint from a customer is to result in court action, he would lose his savings. He gave the example that if he had provided an estimate, and the installer had caused an 'omission', potentially the customer could sue him for the cause of omission.

44. Mr Cation drew the distinction between himself working as a consultant for Glassal, and Glassal as his 'start-up' investment, to be 'a small specialist glazing contractor' to work

'logistically' with clients in 'smaller projects' which are 'too small' for Henshaw; that was 'the gap in the market'. His consultancy to Glassal was to be a 'Contractor QS' (not in the chartered sense, he said), but by dealing with the engagement of sub-contractors; liaising with main contractors; placing orders; providing the suppliers with the best specifications; estimating the costs according to tender specifications; providing 'caveat' on risks to be ring-fenced for discussion; negotiating contracts in relation to warranty, guarantee, payment terms, and delivery schedules, contractual obligations, labour resourcing. It was noted that DC Consult's invoices to Glassal contained description of its services as: Quantity Surveying – Commerical Management – Estimtaing – Construction Sales – Commerical Negotiations – Contract Administration; Mr Cation gave examples of what these services were.

45. When a job is secured for Glassal, it is 'handed over' to Steve Douglas for delivery of the product, and to arrange for its installation as required. Mr Douglas would go on site to supervise the installers; to ensure compliance with Health and Safety (noting that summer and winter risk profiles are very different). The risk issues and comments and technical notes from Mr Douglas would go with the tender; and Mr Douglas would check all aspects of installation before signing off and handing over the installed product to the main contractor. Glassal thereby became 'part of the network of installers', and that 'brings opportunities to us as installer'. Unlike some suppliers which do not install, customers would come direct to Glassal; with 'better enquiries, business grew in volume and quantity'.

46. As to Peter Cation's service, Mr Cation described his father as acting 'as the sounding board' to him, a 'mentor', and that they would have discussions over a cup of coffee on Saturday morning or in the evenings. His father had provided much advice in 2011-12 about setting up in self-employment, on matters such as trading medium, partnerhsips (advice which he had not taken). David Cation mentioned that he had himself also attended business start-up evening courses from 2008, run by Scottish Enterprise, which had among other things recommended the employment of consultancy support. Mr Cation said that even on the occasions when he did not follow his father's advice, 'it was still valuable'.

47. As to what his father did for his business of DC Consult, he said 'ferreting around' for prospective customers, doing 'the detective work'; that he asked his father to 'dig' around 'actual projects' by gathering information in two respects: (i) a builder may potentially have another project to which Glassal can supply; and (ii) to make a prospective customer aware of the full range of products Glassal can offer, which, he said, is always the 'final closing marketing statement' to end any conversation. He said his father's role was 'non-technical', but that his father was experienced in dealing with owner-managers of small business – the approach to them was very different from the large multi-national clients he was used to in his employment roles.

48. In terms of quantification of the amount to pay Peter Cation, Mr Cation explained that his father was his 'sales representative on the road ferreting about' for three years – 2011, 2012 and 2013, and 'to pay him £10,000 per year was good value for money'; that his father was 'embarrassed by the number', but settled with £30,000. Mr Cation while he 'could have got him down further', having given his father the £7,000 to begin with (£6,000 on 26/2/2016 and £1,000 on 7/3/2016), but £30,000 was arrived at, being one-third of the £90,000 turnover (i.e. £20,000 declared by David Cation in the year 2013-14, and the £70,000 for 2014-15).

49. When giving his evidence, Mr Cation stated at one point, in connection with his stake in Glassal, that he and Mr Douglas each put in £10,000 as a loan to the company, and that his father lent him £7,000 towards his share of £10,000. He then said his father got his loan of £7,000 back in April 2013, and that was 'not associated with the £30,000 fees'.

50. On the timing of paying the two lump sums of £10,000 to his father in January and February 2017, Mr Cation was cross-examined and re-examined extensively on why there was a delay of nearly two years from the date of the invoice, that of 1 March 2015. Mr Cation explained that it was all related to the trading results of Vicenti , which had one year of trading since being incorporated in January 2016, and delivered 'profits ahead of where [he] needed to be'. He decided to use the dividends of £10,000 in January 2017 and £10,000 in February 2017 from Vicenti to 'settle his account' with his father.

51. Various questions were put to Mr Cation as regards the timing of the hand-written invoice being dated 1 March 2015, he said it was in December 2014 when they 'started to finalise' the quantum of the payment. However, due to his family commitments financially, (these were related in some detail during re-examination), the final payments were postponed till 2017.

52. In relation to the Enquiry Register, Mr Cation confirmed that it was he (not his father) who undertook 'on behalf of Glassal' the drawings, diagrams, plans, estimates of costs in relation to each enquiry, all of which he would 'feed to Glassal'. Under cross-examination, Mr Cation stated that in relation to each tender, his father would be 'ringing the contractor under the name of Glassal – not as DC Consult', that his father was 'representative of Glassal' to find out why a tender was not successful.

53. HMRC asked why the Register was not produced during the enquiry, and why JGBA had implied that in their first letter of 9 February 2017 that no such records existed. Mr Cation replied that the Register was Glassal's document, a 'living register' beign updated daily or weekly, and that the outcome with HMRC was seen as 'a fait accompli' and that the opportunity to go to the Tribunal was seen as the time to produce this further evidence.

54. The Tribunal asked: 'Did you think of [your father] as your consultant?', reminding Mr Cation that he had previously used 'my assistant' to describe the role of his father in DC Consult. Mr Cation replied that his father was his 'assistant' in terms of sale representation, but in 'mentoring' him, he regarded him as his 'consultant'. When asked if his father used the term 'consultant' in relation to his work for DC Consult, Mr Cation replied in the negative, and said that his father preferred to use the term 'agent'.

55. As to whether it was a deliberate error to claim deduction of £30,000, Mr Cation said that he had taken the advice of JGBA to make the claim 'before the payment was complete'. His refrain in defence of this being a deliberate error to reduce his tax liabilities was to ask the rhetorical question: 'Why would anyone pay £30,000 to save £14,000 of tax?' He reiterated that he had genuinely parted with £30,000 to his father, and that was a genuine business expense; and that he had not made a deliberate error in making the deduction claim.

56. Mr Cation accepted that the 2014-15 enquiry had prompted him to complete a 2013-14 return. He said he did not consider the £20,000 fees received during 2013-14 as 'earned' because he 'might need to re-invest' those funds as 'there were several tight spots' during that period. He had not realised previously that he should have notified HMRC that he had started trading, and futher discussion with JGBA 'drew out that failure'. He said he filed the 2013-14 return with his daughter's help rather than pay a fee for JGBA to file for him.

57. The Tribunal asked Mr Cation how the £20,000 had been invoiced and paid, and Mr Cation said that there were a series of eight invoices of £2,500 each; that pyaments could be delayed by two months or so, depending on the cash position in Glassal. Asked about re-investing that money, Mr Cation said tit had nto in the ned been required. No actual re-investment had been made since the original £10,000 sum.

THE APPELLANT'S CASE

58. Mr Brothers invited the Tribunal to make certain findings of fact, which were enumerated in his oral submissions. We make no reliance on what was proposed to us in making our fact-findings, but have related some of the most relevant of those proposed findings in so far as Mr Brothers' submissions have founded on them.

(1) HMRC's closure notice was based on 'one ground and one ground alone', namely: the £30,000 was not wholly or exclusively for the purpose of the trade. No other argument was advanced by HMRC in relation to quantum or apportionment; that HMRC had taken an 'All or Nothing' approach. However, the fundamental issue was that during the entire course of enquiry, HMRC had not been able to identify any 'non-trade purpose' for the £30,000, and Officer Sutherland's oral evidence admitted as much.

(2) Mr Brothers submitted that there were similarities to the *Copeman* case, where the High Court concluded that it was necessary to 'find as a fact whether the sums in quesiotn were wholly and exclusively laid out for the purpose of the Company's trade, and if they were not, to find how much such sums was wholly and exclusively laid out for the purposes of the Company's trade'. This approach of apportionment under ITTOIA s 34(2) is now standard as per HMRC's guidance BIM37007.

(3) Mr Brothers submitted that Peter Cation became a 'creditor' of DC Consult when the hand-written invoice was raised, dated 1 March 2015, and that Peter Cation entered the £30,000 into his '*2014-15*' return and paid the tax of £7,265 on *3 February 2016*. (Mr Brothers was wrong in relation to the year of the return, and the date of the tax payment, and was corrected before he continued.) The cheque to pay the tax was cleared on 3 February *2017* as evidenced by the bank statement, (and ITFS' letter of 9 March 2018 also gave the wrong year of tax payment as 3 February 2016, although year of Peter Cation's SA return was correctly stated as 2015-16).

(4) It was submitted that a payment can serve 'a variety of reasons' where one of the reasons is a trade reason; that the wholly and exclusively test is a purpose test, and that there was a 'clear purpose' related to the trade of DC Consult: *Bentleys and Stokes*.

(5) The test is a 'subjective' test: *Scott Bader* – the intentions of the parties should therefore weigh heavily in the consideration, and Mr Cation as the taxpayer remains firmly clear that he paid his father the £30,000 for the purpose of supporting his trade.

(6) Applying *Vodafone v Shaw* and *Mallalieu v Drummond* , which point to duality of purpose and the approach in establishing the subjective intentions and trade purpose, iMr Brothers submitted that David Cation lacked the skill sets his father had and wanted his mentoring and coaching to succeed in his business. As David Cation was still in full-time employment, he needed help to promote the sale side of the business and 'outsourced' the work to his father – 'it is a red herring that the supplier happened to be his father'.

(7) The question of timing that HMRC had focused on is also 'a red herring'; the arrangement was between father and son and the payment was 'agreed' to be made on his success; the accountant on receiving the facts judged that it was an 'accrual'; the accounting was done correctly.

(8) If HMRC were to assert 'duality of purpose', that would be 'a red herring too'; 'no evidence was brought forward for any other purpose' than trade purpose.

59. On the penalty assessments, Mr Brothers submitted that:

(1) It was 'objectively reasonable' to have claimed the deduction, having taken advice that on an accrual basis, it was reasonable to claim the relief before the full payment.

(2) The burden of proof for deliberate conduct, of intentionality is set at a high bar: *Cannon*. HMRC had not reached that bar.

(3) The Sch 24 penalties should be mitigated by 100% for full telling, helping and giving. At the very least, they should be reclassified as 'careless', and suspensive conditions set.

(4) As regards the FTN penalty, Mr Cation had a reasonable excuse, and that was he did not know when trading commenced; and whether income should be considered as trading income.

(5) With the reasonable excuse, the failure was 'no worse than careless' and suspension conditions to be set as well.

HMRC'S CASE

60. In reply to Mr Brothers' submissions, Mr Mason averred that:

(1) The substantive issue of whether the payment was wholly and exclusively incurred for the purpose of the trade of DC Consult is not for HMRC to prove.

(2) At all times, the appellant was represented, and yet there was a reluctance to provide records to substantiate what was being done by Peter Cation for the sole trade.

(3) The Enquiry Register was not produced to HMRC at any stage of the enquiry, and was the only document that provides evidence of the size and scale of the trade involved.

(4) The cumulative value of the Enquiry Register was around £4.5m; HMRC consider that the prospective customers would not be dealing with sole-traders or small businesses (like DC Consult) but with companies (like Glassal).

(5) There was conflicting evidence from witnesses as to the frequency and hours worked by Peter Cation; there was no evidence of these calls made to prospective customers to develop the business of DC Consult; and if any work was undertaken, it was to develop the business of Glassal, not the sole trade that claimed the expense.

(6) A failure to keep records for business expenses as required by s 12B TMA means there is no proof that the payment was for any genuine business purpose. Peter Cation had considered he was giving his advice and time freely, more in the nature of an informatl father-son relationship, and that his services were 'a piece of fun'.

(7) The £30,000 payment represented 40% of the turnover in 2014-15. It was too much of a coincidence that the two sums of £10,000 were paid in January and February 2017 after HMRC had opened enquiry on 10 January 2017. Mr Mason emphasised that there was no way of knowing how the £30,000 fee had been calculated, or how Peter Cation's time had been costed, and it seemed 'excessive' for any such non-technical role.

61. In relation to the penalties, Mr Mason submitted that:

(1) The appellant had failed to notify his liability as a self-employed in accordance with the obligations under s 7 TMA, despite all the discussions with his agent and with his father about self-employment: *Clynes* at [86]

(2) HMRC have not seen these accounts of DC Consult with Peter Cation being booked as a 'creditor'; the agent's letters from JGBA replying to the enquiry never made such a point. The 2014-15 return claimed business expenses of £30,000 when only £3,000 had been paid in the year. The £20,000 paid in January and February 2017 was 'paying after the fact' and the lump-sum payments were triggered by the opening of enquiry. Paying after the fact was a 'deliberate' attempt to give legitimacy to the claim.

(3) HMRC have already made the distinction that the errors were 'deliberate but no concealed'; there had been a lack of evidence to substantiate the claim; the mitigation for telling, helping and giving is fair, and there is no further reduction HMRC can make.

DISCUSSION

Whether wholly and exclusively for the purposes of the trade

Burden of proof

62. Whether an expense meets the statutory condition to be eligible for relief can be a question of law as well as a question of fact. While the 'wholly and exclusively' test is primarily a question of fact, there are instances where the factual test is preceded by a question of law, as in *CIR v Dowdall O'Mahoney & Co Ltd* [1952] 33 TC 259, where the taxpayer company claimed deduction of Irish taxes as a trading expense, and its appeal was allowed by the Commissioners. On appeal, the taxpayer argued that the 'wholly and exclusively' test was purely 'a question of fact' and that therefore the Commissioners' decision on the matter was final. This argument was rejected by Lord Reid:

> 'I cannot accept this argument. If certain payments made by a taxpayer are of such a kind that they are capable in law of being regarded as coming within the exception in [what is now s 54(1)(a) CTA 2009] then no doubt it is for the Commissioners to determine whether the circumstances of the case are such that in fact they come within that exception. But it is in my judgment a question of law whether particular payment are of a nature capable of coming within the exception, and that is the issue here.'

63. It is an important distinction, and we have considered whether the substantive matter in this appeal involves a preceding question of law before we can determine the issue as a question of fact. Parties have not sought to advance their case on the characterisation of the expenditure and its deductibility as a question of law. From their respective submissions, there is common ground that the Tribunal is called upon to determine the issue only as a question of fact.

64. On the footing that the issue is to be determined as a question of fact, it is clear that the appellant has the onus of proof, on the balance of probability, that the expenditure meets the s 34 test to be allowed as a deduction. However, Mr Brothers' submissions seem to suggest that HMRC have to make a positive case that they have identified a non-trade purpose to underpin the decision of disallowing the £30,000 payment. To that end, Mr Brothers has referred us to HMRC Business Income Manual 37007 (on s 34 ITTOIA and s 54 CTA 2009), where it is stated, under the heading of 'Sole Purpose' that:

> 'The legislation disallows any expenditure not incurred wholly and exclusively for the purposes of the trade, profession or vocation. This means that the rule is only satisfied if the taxpayer's sole purpose for incurring the expense is for the purposes of their trade, profession or vocation. *If you identify a non-trade purpose then the expenditure is not allowable*.' (italic added)

65. The Manual is intended as internal guidance for decision makers, and the 'you' in the italicised sentence refers to an HMRC officer. As the decision maker of the closure notice, Officer Sutherland was questioned as to whether HMRC have identified any 'non-trade purpose' for the £30,000 payment. Mr Brothers' submission in this respect turns on the fact that Officer Sutherland conceded that he had not identified any 'non-trade purpose' for the £30,000 payment, and therefore HMRC have no basis to disallow the expenditure.

66. Any reliance on the Manual is misguided, since it has no force in law. Furthermore, the italicised sentence says no more than that if an HMRC officer has identified a non-trade purpose, then there is a *prima facie* case to disallow the expense, with the corollary that no

further enquiry would be necessary. We do not consider the manual in any way places, or reverses, the burden of proof on HMRC to make a positive case that a decision to disallow an expense is predicated on a non-trade purpose being identified.

67. In any event, the appealable decision by HMRC is a closure notice, and in accordance with s 50(6) TMA, it is for the taxpayer to show that the notice, and the consequent amendments to the 2014-15 SA return are incorrect; otherwise the closure notice amendments stand good.

Legal principles from case law

68. Section 34 ITTOIA provides that '[i]n calculating the profits of a trade, no deduction is allowed for expenses not incurred wholly and exclusively for the purposes of the trade'. Case law on the predecessor provisions of s 34 ITTOIA (and s 54 CTA 2009 for corporation tax) remains relevant since the statutory wording for the 'wholly and exclusively' requirement is essentially unaltered.

Business purpose to be distinguished from taxpayer's object

69. In *Mallalieu*, the House of Lords considered the meaning of the predecessor provision under s 130(a) of the Income and Corporation Tax Act 1970, which provided that in computing the profits or gains, no sum shall be deducted in respect of:

> '(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation, …'

70. Lord Brightman (with whom three Law Lords agreed, Lord Elwyn-Jones dissenting) explained that the statutory words 'expended for the purposes of the trade' mean 'expended *to serve the purposes* of the trade', and in turn could be elaborated as 'for the purpose of enabling a person to carry on and earn profits in the trade'. The italics is original to emphasise the distinction to be drawn between the purposes of the business and the purposes of the taxpayer.

> 'The particular words emphasised do not refer to "the purposes" of the taxpayer as some of the cases appear to suggest; … They refer to "the purposes" of the business which is a different concept although the "purposes" (ie the intentions or objects) of the taxpayer are fundamental to the application of the paragraph.'

The time frame for determining taxpayer's object

71. The taxpayer's object in making the expenditure is entirely referential to the moment when the expenditure is incurred, as explained by Lord Brightman:

> '… whether the money was expended to serve the purposes of the taxpayer's business it is necessary to discover the taxpayer's "object" in making the expenditure …. As the taxpayer's "object" in making the expenditure has to be found, it inevitably follows that … the commissioners need to look into the taxpayer's mind at the moment when the expenditure is made. *After events are irrelevant to the application of s 130 except as a reflection of the taxpayer's mind at the time of the expenditure*.' (italics added)
>
> If it appears that the object of the taxpayer at the time of the expenditure was to serve two purposes, the purposes of his business and other purposes, it is immaterial to the application of s 130(a) that the business purposes are the predominant purposes intended to be served.'

'Object' to be distinguished from 'effect' in determining exclusivity

72. Lord Brightman then set out how the issue of exclusivity of purpose is to be determined by distinguishing the 'object' from the 'effect' of incurring an expenditure.

> 'The object of the taxpayer in making the expenditure must be distinguished from the effect of the expenditure. An expenditure may be made exclusively

> to serve the purposes of the business, but it may have a private advantage. The existence of a private advantage does not necessarily preclude the exclusivity of the business purposes.'

The conscious motive not conclusive of the matter of object

73. It is accepted that the 'object' of the taxpayer in incurring the expenditure would involve ascertaining the subjective intention at the time, as enunciated by Waller LJ in *Scott Bader*:

> 'In my judgment "purpose" contains an ingredient of "intention". It is very difficult, but perhaps not impossible, to determine this without some element of subjectivity. Indeed, in many cases the test will be wholly subjective. ... The court has to decide the real purpose, if it is for the trade, vocation or profession, and whether it is independent, ie independent of the business purposes to be served …'

74. The subjective motive of the taxpayer at the time of the expenditure, although of significance in determining the object of the expenditure, is not conclusive of the matter. In *Mallalieu*, the Commissioners dismissed the taxpayer's appeal based on inferences drawn from their primary findings of fact. The High Court reversed the Commissioners' decision and allowed the taxpayer's appeal by holding that the conscious motive of the taxpayer was decisive, and that the Commissioners were not entitled to draw inferences that there was dual purpose for the expenditure. The Court of Appeal similarly held that what was present in the taxpayer's mind at the time of the expenditure concluded the case. However, Lord Brightman found himself 'totally unable to accept this narrow approach' and said:

> 'I reject the notion that the object of a taxpayer is inevitably limited to the particular conscious motive in mind at the moment of the expenditure. Of course the motive of which the taxpayer is conscious is of vital importance, but it is not inevitably the only object which the commissioners are entitled to find to exist.'

Findings of fact

75. From the legal principles related, it is clear that there are different elements of proof required in relation to the statutory test under s 34 ITTOIA, which is to allow deduction *only* for expenses incurred wholly and exclusively for the purposes of the trade. The findings of fact relevant to determining the appeal are therefore in relation to: (a) what expense was incurred; (b) what was the purpose of the trade; and (c) whether wholly and exclusively.

76. Whilst Mr Brothers had urged on the Tribunal to give weight to the subjective intentions of Mr Cation in expending the sums, the subjective intentions of the taxpayer are not determinative as held by the House of Lords in *Mallalieu*. The relevant test for s 34 concerns the 'purpose of the trade', and the Tribunal has to decide 'the real purpose' of the expenditure, whether it is for the trade, vocation or profession, or whether it is independent of the business purposes to be served. The subjective intentions of the taxpayer does not necessarily equate to the real purpose of the expenditure for s 34 purposes.

77. Where was the real purpose of the £30,000 expense to be found? In terms of documentary evidence, there is a dearth of contemporaneous records to support the appellant's case. What was so obviously missing is a collateral written agreement to substantiate the terms between the payer and payee for the £30,000 fees. The only material documentary evidence produced consisted of: (i) the hand-written invoice, (ii) the bank statements to show the flow of funds to Peter Cation's account, and (iii) the Enquiry Register for Glassal. However, nothing emanating from these documents is in itself sufficient for the appellant to prove his case, and the content and substance of all of these documents stand to be tested against witness evidence. The appellant's case therefore relies heavily on the testimonies of Peter Cation and his own.

78. We find the appellant to be sharp, sophisticated, and successful in his chosen career by being able to combine his technical expertise as a chartered surveyor with extensive business experience as a pre-contract, and then sales, director. He was adept in dealing with sizeable contracts of substantial value for his former employers; he needed to have an eye for detail to pitch a tender, to negotiate contractual terms, to advise on deliverable warranty underpinned by sound risk assessments. From his evidence, we find Mr Cation to have considerable business and commercial acumen, as illustrated by his discernment in identifying a gap in the market for Glassal to move into, and by creating an operation niche for Glassal by being a supplier *cum* installer (even if this was jointly achieved with Mr Douglas). He has an excellent sense as to how best to market Glassal, not only through the supply and installation networks that feed into each other, but also via the system of following up enquiries to ensure that Glassal would become more known to a wider network of main contractors. The so-called 'final closing marketing statement' in any follow-up calls to make known the range of products supplied by Glassal is a reflection of the savviness of Mr Cation in relation to sales and marketing.

79. In contrast, we find Peter Cation's business experience was altogether different, which he aptly summed up as he was 'dealing in tens of thousands' while his son was dealing in 'hundreds of thousands'. The disparity in the business backgrounds between father and son makes any claim that Peter Cation provided mentoring and coaching at a level commensurate with a consultant in an open market to be paid a comparable fee flawed and hard to substantiate.

80. Apart from mentoring and coaching, the appellant claimed that his father did 2 days a week for his business. We accept that there was some input by Peter Cation for the business of DC Consult, but we are unable to make a finding that it amounted to 2 days a week. Under cross-examination, there was a discernible element of discomfiture in Peter Cation's demeanour, which seemed to us to be caused by a degree of tension as to what he considered he could state to assist his son's case without compromising his personal integrity. We find Peter Cation's oral evidence as regards the 'ferreting' he did for his son to be so lacking in particulars, and at times so uncertain, as to be unconvincing (e.g. §39(1) Glasgow, '*maybe*' Edinburgh, Aberdeen). We do not doubt that Peter Cation values his personal integrity highly, which lent him to admitting readily that the time he spent in assisting his son was 'genearlly a lot less' than the purported 2 days per week in the witness statement.

81. Whilst we do not find that Peter Cation in any way set out to mislead the Tribunal, it was obviously difficult for him to try to elaborate on an extensive, and sustained programme of ferreting that was supposed to have lasted some 3 years. We note the replies on the follow-up calls Peter Cation made to be 'sometimes', 'two-three-four calls', and 'occasionally'. If there was indeed work done in the nature of ferreting of an extent to merit the award of 33.3% share of the appellant's turnover in the tax years (however apportioned between mentoring/coaching and ferreting/follow up of enquiries), then one would expect that there would have been no lack of details to substantiate the work done during Peter Cation's oral testimony. We alo note HMRC's valid challenge of the categorisation of 'small owner-managed businesses' (as a niche sector for Peter Cation) being an apt description of the clients on the Enquiry Register, which included well-known firms of architects, engineers, building constructors, estate agents, and a regional prison, and questioned how Peter Cation could have visited these potential customers.

82. The onus is for the appellant to establish the purpose for which the expenditure was incurred, and the decision as to the purpose is entirely a question of fact. As the fact-finding tribunal, we need to find the facts in relation to the questions: (a) What was the object or purpose of the expenditure? (b) Was it to benefit or further the trade carried on by the taxpayer in question or for some other purpose? Our findings of fact are as follows:

(1) Any 'assistance' given by Peter Cation under the appellant's direction was 'occasional' as Peter Cation stated; it was for 'a piece of fun, to cover his son's time', and for which he did not expect to be paid. The assistance given was the occasional phone calls made on his son's behalf to follow up a submitted tender; it was neither technical nor at consultancy level. It was *ad hoc* and there was no regular work arrangement in place to engage Peter Cation's service to support the 2 days a week purported to have been worked in a three-year period leading to the £30,000 fees.

(2) As to the 'ferreting over a three-year period' claimed by the appellant to have been carried out by Peter Cation, no credible evidence was produced to support the assertion; nor was it convincing that Peter Cation's business contacts as a sales representative (in polystyrene containers or fancy party outfits) would have been of any utility to the targeted market of bespoke glazing systems. From the Enquiry Register, we note that the geographical spread of the locations of the projects was vast, covering all major Scottish cities such as Edinburgh, Glasgow, Dundee, Stirling, St Andrews, Inverness, Aberdeen, Perth, and notable towns in between cities such Ullapool, Prestwick, Toridon, Campletown, Fort William, Ayr, Melrose, North Berwick, Hawick and Wick, etc., with the furthest south being Halifax (north England), and the furthest north being Orkney (Outer Hebrides). It was improbable that these enquiries with their vast geographical spread would have been, in any significant extent, due to the ferreting by Peter Cation. Rather, and as Peter Cation said: 'the name [ie Glassal] had been bandied about in the business' already, and that was more likely to be through the efforts and contacts of David Cation and Steve Douglas, who have had decades of experience working in the construction industry, than Peter Cation's ferreting efforts.

(3) The appellant repeatedly referred to 'the skill sets he lacked', which his father was said to have supplied through mentoring and coaching and in that respect was acting as a 'consultant' to him. We find the so-called 'mentoring' and 'coaching' by his father to be 'consultancy' to be an overstatement. We find that Peter Cation's business experience was limited to being a sole trader, and as a sales representative in low-value merchandise, while the appellant is clearly very alive to the risk exposure associated with him operating in a sector dealing with high-value contracts, involving warranty and health and safety issues that could lead to court actions. The appellant might have used his father as a 'sounding board', but the business environment in which he operates is so materially different to that of his father's as to make it highly unlikely that his father's business experience could have enabled him to mentor or coach the appellant in making any strategic or syllogistic decisions. We accept that there was wisdom passed from father to son, but there is no evidence to support that it was at the level of consultancy to merit a going market rate as calibrated to the £30,000 claim.

(4) In the tax year 2014-15, the actual sum paid to Peter Cation was £3,000, made up as 4 payments of £750 each, and not the £30,000 as claimed in the return. In 2015-16, the total sum paid to Peter Cation was £7,000. These payments could have been for any reasons between father and son. (We note that the appellant gave the figure of £7,000 as the sum of loan advanced by his father towards start-up capital for Glassal, which he claimed to have been repaid in April 2013; no further evidence was adduced in relation to the repayment date.)

(5) The two lump sum payments of £10,000 each to Peter Cation, made on 25 January 2017 and 10 February 2017, were most probably triggered by the opening of the enquiry on 10 January 2017. Peter Cation's evidence supported that the lump sum payments were unexpected, something out of the blue for him, and he knew not whether it was a 'gift' or a 'salary'. The hand-written invoice, the amendments to Peter Cation's 2015-16 return

to include the £30,000, and the tax payment of £7,265 on 3 February 2017 were actions consequent upon the lump-sum payments being triggered by the enquiry. The lump sums were received by Peter Cation in the tax year 2017-18, but were included in 2015-16 return by amending the original return already submitted. On the balance of probability, the two lump-sum payments of £10,000 each were triggered by the opening of the enquiry in Janaury 2017, and explained why there was this mismatch in tax years for the relevant events: (a) the claim of £30,000 was made in the appellant's 2014-15 return, (b) the payments were made in 2017-18 tax year; (c) the receipts were included retrospectively by amending Peter Cation's 2015-16 return. We reject the explanation of accruals being the reason for the mismatch in timing.

(6) We also reject the appellant's explanation that the timing of the payments in January and February 2017 (being nearly two years after the supposed date of the hand-written invoice) was due to Vicenti's good trading results, which allowed him 'to settle his account' with his father at that juncture. At no time during the course of the enquiry had this explanation been proffered. The existence of Vicenti was only brought up in the appellant's oral evidence, and it seems to us that the Vicenti explanation for the timing of the lump-sum payments totalling £20,000 was an explanation *after* the event, and not the real reason at the time why the £20,000 was paid.

(7) Having considered the evidence in its totality, we find the £20,000 was paid in 2017 following the opening of the enquiry. Applying case law principles, the conscious motive of the appellant in expending the £20,000 at that juncture was to attempt to make good what he claimed as having been incurred; that is, to 'pay after the fact'.

83. As the appellant stated, he drew a distinction between Glassal and DC Consult; Glassal was his start-up investment, and DC Consult was the trade in question for which the s 34 relief for £30,000 was claimed. HMRC submitted that any ferreting purported to have been carried out would have been carried out for the purposes of the trade of Glassal, and not the trade of DC Consult. In reply, Mr Brothers submitted that Peter Cation was retained by DC Consult and it was therefore no consequence if he was holding himself out to customers as a representative of Glassal. Based on our conclusion that the appellant has not discharged the burden that the £30,000 paid to his father was 'wholly and exclusively' for the purpose of the trade of DC Consult, it is unnecessary for us to go on to consider the relevance of HMRC's submission in relation to the existence of two entities of Glassal of DC Consult for s 34 purposes.

84. The issue of apportionment was raised by Mr Brothers in his submission, which seemed to suggest that HMRC had been wrong to take an 'all or nothing' approach. However, the burden of proof on any justifiable basis for apportionment rests squarely on the appellant. It is not for HMRC to ascertain the basis of apportionment in the absence of any proposal from the appellant. It is peculiar that the apportionment issue was raised in submission when we had heard no evidence on any alternative basis to quantify what might have been a reasonable amount for s 34(2) purposes in relation to the payments made to Peter Cation. It seems to us that in the absence of any evidence being adduced for apportionment, the appellant's case has been staked on an 'all or nothing' basis.

85. The Tribunal is devoid of any basis to consider apportionment in the absence of relevant evidence being so adduced. Nor are we able to establish any reasonable basis for apportionment from the scant documentary evidence, which highlights the fundamental issue that beset the appeal from the outset; namely, there was a blatant failure to keep contemporaneous records as required by s12B TMA to support what might have been done by Peter Cation for DC Consult.

Penalties

Schedule 24 penalty for 2014-15

86. Based on our conclusion that the £30,000 paid to the appellant's father was not eligible for s 34 ITTOIA relief, there is a *prima facie* case that there was an inaccuracy in the return for a penalty under Sch 24 to be assessable. As to the error being deliberate, we agree with Judge Morgan in *Clynes v HMRC* when she said that:

> '[82] … for there to be a deliberate inaccuracy on a person's part, the person must to some extent have acted consciously, with full intention or set purpose or in a considered way. …'
>
> '[86] … depending on the precise circumstances, an inaccuracy may also be held to be deliberate where it is found that the person consciously or intentionally chose not to find out the correct position, in particular, where the circumstnaces are such that the person knew that he should do so….'

87. We find the appellant to be shrewd, as illustrated by the reasoning behind the choice of incorporating Vicenti to be a separate company from Glassal, and by his awareness and assessment of the risk exposure by forming a limited company. This astuteness means that he would have had the awareness and means to gather the requisite information if he had chosen to do so in relation to the unsound basis for making the s 34 claim as he did.

88. The observations in *Clynes* are apt to the circumstances that gave rise to the inaccuracy in the 2014-15 return, which we do not accept to be 'careless', given the personality and acumen of the appellant as we have found. As to the argument that no person in the right frame of mind would have paid £30,000 to save tax of £14,000, we are of the view that the appellant had taken a calculated risk, that his s 34 claim might have gone through under self-assessment without HMRC opening an enquiry in time.

Schedule 41 penalty for 2013-14

89. The appellant clearly understood his obligation to file an SA return to declare his self-employed income for 2014-15 when his turnover reached £70,000. There was no good reason for not returning the £20,000 he had received in 2013-14 in like manner, as self-employed income as when it arose. It is significant to our consideration of the FTN penalty being 'deliberate' that the appellant took no steps in January 2016 (when he was filing his 2014-15 return) to file his (by then late) 2013-14 return. He had instructed JGBA as agent; he should have known by then, that the £20,000 received in 2013-14 was to be treated in the same way as the £70,000 he received in 2014-15. The timing of the 2013-14 return being filed in June 2017 was indicative of it being prompted by the ongoing enquiry into 2014-15. We therefore uphold the FTN penalty assessed as 'deliberate and prompted', with the quantum being adjusted to take into account the augmented PLR upon reclassifying the £20,000 under self-employment, thereby removing the necessity to assess under Sch 24 the element relating to the error arising in returning the £20,000 as 'Other Income'.

90. The explanation offered why the £20,000 was not returned at the time was that the appellant was not sure that he had earned it. We find this explanation inconsistent with how the appellant also claimed that he had based the fees payable to his father as one-third of £90,000 (which was inclusive of the £20,000), and the quantification was reached in December 2014. If we were to take the appellant's evidence at face value that there was an agreement reached in December 2014 to pay Peter Cation £30,000, it would seem that by December 2014, he had reckoned the £20,000 as 'earned' by including it in the fee calculation for Peter Cation. If the appellant had reckoned the £20,000 as earnings by December 2014, and waited till March 2017 to notify HMRC that he had to make a return for 2013-14, that was a deliberate failure in terms as described in *Clynes*.

DISPOSITION

91. The appeal is dismissed. The decisions under appeal are confirmed as follows:

(1) In relation to 2014-15, the closure notice amendments to the self-assessment return stand good, with the additional income tax liability of £14,880.94 being confirmed.

(2) The penalty assessment under Schedule 24 FA 2007 in the sum of £7,812.49 in relation to inaccuracy in the 2014-15 return is also confirmed.

(3) In relation to 2013-14, the penalty assessment under Schedule 41 FA 2008 in the sum of £4,677.96 is confirmed; the penalty assessment under Schedule 24 FA 2007 is reduced to nil.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

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.

DR HEIDI POON
TRIBUNAL JUDGE

RELEASE DATE: 04 SEPTEMBER 2021