Neutral Citation: [2023] UKFTT 00860 (TC)

Case Number: TC08961

FIRST-TIER TRIBUNAL
TAX CHAMBER

In public by remote video hearing

Appeal reference: TC/2023/00631

STRIKE OUT – no reasonable prospect of success – FRS 105 considered – application granted

Heard on: 29 September 2023
Judgment date: 12 October 2023

Before

TRIBUNAL JUDGE NIGEL POPPLEWELL

Between

HART ST MALTINGS LTD

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Paul Springett director of the appellant

For the Respondents: Shkar Kider litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. This decision deals with a strike out application brought by HMRC on 14 April 2023 ("**the application**"). The background to the application can be simply stated. It is HMRC's view that the appellant (or "**the company**") was obliged to adopt an accruals basis of accounting for the accounting periods in question. It acquired and then redeveloped a single building into two properties, known as House 3 and House 4. It sold House 4 in the accounting period ended 28 February 2018. In its accounts and tax return for that period it offset, against the proceeds of sale, not merely the costs of developing House 4, but also the costs, to that date, of redeveloping House 3.

2. In HMRC's view, this was not in accordance with the relevant accounting principles, and on 28 February 2022, HMRC made a discovery assessment in an original amount of corporation tax of £44,662.94, which is now increased to £45,639.62 ("**the discovery assessment**").

3. On 16 January 2023, the appellant notified its appeal against the discovery assessment to the tribunal ("**the appeal**"). It is HMRC's view that the appeal has no reasonable prospects of success in light of the fact that the appellant has clearly failed to compute its profits in accordance with generally accepted accounting practice for the accounting period in which House 4 was sold.

4. For the reasons given later in this decision, I have decided to allow the application, and accordingly the appeal is struck out with immediate effect.

THE LAW

5. There was no dispute about the relevant law.

6. I have set out in the appendix the relevant First Tier Tribunal Rules 2009 (as amended), together with an extract from the legal principles which I must consider when approaching a strike out application (set out in *The First De Sales Limited Partnership and others v HMRC* [2018] UKUT 396).

7. Under section 8 of the Corporation Tax Act 2009 corporation tax for a financial year is charged on profits arising in that year. That corporation tax is calculated and chargeable by reference to accounting periods. It is assessed and charged on the full amount of profits arising in the accounting period. Under section 46 of that Act, profits of a trade must be calculated in accordance with generally accepted accounting practice.

8. Under Financial Reporting Standard 105 ("**FRS 105**"):

> 2.15 The uncertainties that inevitably surround many events and circumstances are acknowledged by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias…

> 2.21 A micro-entity shall prepare its financial statements using the accrual basis of accounting. On the accrual basis, items are recognised as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items…
>
> 2.26 The recognition of income results directly from the recognition and measurement of assets and liabilities. A micro-entity shall recognise income in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.
>
> 2.27 The recognition of expenses results directly from the recognition and measurement of assets and liabilities. A micro-entity shall recognise expenses in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably…
>
> 10.20 When inventories are sold, the micro-entity shall recognise the carrying amount of those inventories as an expense in the period in which the related revenue is recognised…
>
> Glossary: accrual basis (of accounting): The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

9. Under paragraph 41 of Schedule 18 to the Finance Act 1998, an officer of HMRC may make a discovery assessment if he/she discovers that an amount which ought to have been assessed to tax has not been so assessed. The general rule is that a discovery assessment must be made within 4 years from the end of the accounting period to which it relates.

THE FACTS

10. From the documents provided to me as well as comments made by Mr Springett at the hearing, I find the following facts:

(1) The appellant was incorporated on 14 February 2012 and commenced trading on 1 March 2012.

(2) In 2015 Mr Springett became a shareholder in the appellant and, around that time, another company (Hart St Investments Ltd ("**HSIL**"))was incorporated. HSIL provided a number of services to the appellant including the provision of construction services.

(3) The companies were established to redevelop buildings on a site in Henley-on-Thames. These included House 3 and House 4.

(4) HSIL secured bank financing and engaged contractors to carry out the redevelopment.

(5) House 4 was sold by the appellant in the accounting period ending on 28 February 2018. The accounts for that period includes a "trading and profit and loss account" in which the turnover is expressed to be £975,700, the cost of sales as £1,096403. The account records a gross loss of £120,703.

(6) These costs had been incurred by HSIL and recharged to the appellant. The figures, which were provided by the appellant's accountant, shows that the costs incurred on redeveloping the Houses at the date on which the sale of House 4 occurred, were £520,556 on House 4 and £496,462 on House 3.

(7) In the accounting period ended 2019, further costs incurred by HSIL were recharged to the appellant and allocated to House 3 (£80,219) and House 4 (£77,387).

(8) I was told, and this was not challenged by the appellant, that the appellant adopted FRS 102 for its self-assessment return for the accounting period ended on 28 February 2018, but then submitted amended accounts to Companies House adopting FRS 105. No amended return was filed with HMRC. FRS 105 was then used for subsequent self-assessment returns. Both FRS 105 and FRS 102 require financial statements to be prepared using the accruals basis of accounting.

(9) The appellant declared no assessable profits for the periods 2018, 2019, 2020, and 2021, and assessable profits of £445,481 for the accounting period ended 2022.

(10) These last are profits which arose from the sale of House 3 in that accounting period. It is HMRC's view that the company had assessable profits of £239,138 in 2018, £4,179 in 2019, £21,954 in 2020, £9,942 in 2021, and £170,268 in 2022. The total of these amounts is also £445,481.

(11) Similarly, the company paid no tax until 2022 when its liability to corporation tax was £84,641.39. HMRC's view is that corporation tax should have been paid in respect of each accounting period between 2018 and 2022, the total amount being £84,845.09. This slight difference of £203.70 arises due to a change in the rate of corporation tax in 2018.

(12) The discovery assessment was raised in respect of the first of these periods, namely the one in which House 4 was sold. It was initially raised in an amount of £44,662.94, but on review this was uplifted to £45,639.32. The appellant has made no challenge to either the amount of this discovery assessment nor any other aspects of its validity.

(13) The appellant notified its appeal to the tribunal on 16 January 2023.

(14) In an email to HMRC dated 15 January 2021 from Mr Stephen Grant, partner at Azets (the appellant's accountants) Mr Grant stated:

> "Thank you for your email. I understand the structure in that the company owned a building that it converted into 2 houses. At the 2018 year end it had incurred the costs to construct 2 houses but had only sold one. So in the accounts to February 2018 we need to include the sale proceeds of one house and the costs to construct one house and carry forward the costs to construct the second house to be matched against the proceeds of the second house. Work in progress is the way the costs to construct the second are carried forward. There is no accounting convention or tax law that would allow the cost to construct the second house to be written off in 2018 to create a loss and the in the year the second house is sold to only show the sale proceeds of the second house with no costs. This matching of costs and revenue is a fundamental accounting principal…".

(15) However, in a subsequent letter to HMRC dated 3 December 2021, Mr Grant stated:

> "Accountancy treatment and FRS 105/102

Our client is of the opinion that the cash basis is appropriate as the development is a micro entity and the development should be seen as a whole, and the overall profit only recognised once all properties have been sold. All properties have now been sold and all the profit has been recognised. Our client also advises that the micro entity entitlement was also confirmed by a separate firm of chartered accountants and the costs of sales to individual properties was ascertained by the main contractor's analysis following build completion".

DISCUSSION

HMRC's position

11. HMRC accept that the burden of persuading me that I should exercise my discretion to strike out the appeal on the basis that it has no reasonable prospect of succeeding lies with them.

12. In their view the position is straightforward.

(1) The appellant is and has always been a trading company. It did not file its accounts and declare its profits for the accounting period ended 28 February 2018 in accordance with UK generally accepted accounting practice. Whether it was subject to FRS 102 or FRS 105, the position is the same. It should have accounted for its profits on an accruals basis.

(2) As set out by Mr Grant in his email of 15 January 2021, this requires expenses to be matched to the asset in respect of which they were incurred. This in turn means that only those expenses incurred on House 4 could have been set off against the income received on the sale of that property. Setting off costs of House 3, and setting off costs in the year after it was sold, do not accord with the relevant FRS.

(3) There has been no challenge to the validity of the discovery assessment. The appellant has no reasonable prospect of succeeding in the appeal. It has only a fanciful prospect of success. It has only a merely arguable position.

The appellant's position

13. The appellant's position is as follows:

(1) Whilst it was set up as a trading company, it did not operate as a trading company throughout all of the years in question. It was set up to own a building. The planning process took a long time so the building was left idle. The development was undertaken by HSIL and the costs were recharged to the appellant.

(2) Small company exemption (or micro entity relief) should apply to the appellant. This means the appellant can expense the costs in relation to unsold property against income made on the sale of its first sold property. So, tax is only payable once the appellant moved into profit on the sale of that second property. It is not right for the company to have had to pay tax on an unrealised profit in 2018. Whilst matching is an important concept, financial prudence overrides this.

(3) If the appellant had had to pay tax in 2018, it would not have been able to find the money to do so. All the money was being used for the development. The appellant would not have been able to raise funds to pay tax on profits it had not yet made.

(4) There was never any intention of avoiding corporation tax. The directors' fiduciary duty was to ensure that tax was duly paid on the profit of the development as a whole, not allocate the costs evenly across the two Houses, only to find as a result of an economic crash, the company made an overall loss when the second House was sold which could not be set off against the earlier profits.

(5) The accounting policies which were intended for large companies such as Redrow do not work commercially for a micro developer such as the appellant.

(6) It would have been imprudent to apportion costs between the two Houses given that the first House was sold in 2018 whilst the second was only sold in 2022.

Discussion

14. It is clear to me that during the accounting period ended 28 February 2018, in which House 4 was sold, the appellant was a trading company, and the sale of that property was a trading transaction. This is evidenced from the accounts for that period in which the transaction is described as a trading transaction; the comments made by Mr Springett at the hearing who accepted that it was a trading transaction, and that the original intention on the acquisition of the overall property was to develop it into a number of units which would then be sold (clearly trading); and the fact that for the accounting periods ended 2018 to 2022, the appellant adopted an FRS 105 compliant basis of accounts.

15. As a result of this, for the accounting period ended 28 February 2022, the company's taxable profits had to be computed in accordance with UK generally accepted accounting principles. And to do this the company had to conform with the provisions of FRS 105 (I accept that it was a micro entity in this period).

16. As set out above, this required the appellant to account on an accruals basis during that period. As set out in the email from Mr Grant of 15 January 2021, this means that the costs which could be deducted from the income generated on the sale of House 4 were only those costs which could be matched with that property. Matching the costs incurred at that date of developing House 3 with House 4 was not in compliance with FRS 105.

17. In my view this is very clear, and I am afraid that the appellant's argument to the contrary is very flimsy. It looks to me, from the comments made by Mr Grant in his letter of 3 December 2021 (in which he is very clear that the views are those of the appellant) that the appellant is equating micro entity relief with a cash basis of accounting. There is no such thing as micro entity relief that I know of. Indeed, under FRS 105 a micro entity must account on an accruals basis. And I can see no principled basis for the assertion either made to me directly or via Mr Grant that the appellant was entitled to use cash accounting and thus take into account all of the expenses incurred on the development of House 3 against the proceeds of the sale of House 4.

18. I wholly accept that, commercially, accruing the House 3 expenses would have caused considerable cash flow issues for the appellant. As Mr Springett observes, all of the available money was going into the development and there was nothing left to pay tax. And in his view, it is inequitable that tax was payable on the sale of House 4 when, in commercial terms, the appellant had incurred costs on the development of House 3, and so in overall terms, the appellant had made no profit. But accounting on a cash basis which allows the appellant to do as it did is not permitted by FRS 105.

19. Nor do I think the concept of prudence assists the appellant. Matching costs with the relevant asset is a fundamental principle of the accruals basis. And whilst a degree of caution must be taken in making the estimates of the expenses, the appellant has not seriously challenged its own figures. These are used in the discovery assessment and no challenge has been made to the quantum of that assessment.

20. Prudence does not allow the deliberate understatement of assets or income or the deliberate overstatement of expenses. It does not permit bias. In the circumstances of this appellant, I can see that whilst it was commercially and financially expedient to adopt what was in effect a cash basis accounting, that is very different from prudence which, as an overarching concept, does not in these circumstances affect the obligation on the appellant to match costs with the relevant asset. To do otherwise would be a deliberate overstatement of expenses.

21. In considering whether to strike out the appellant's appeal, I must consider whether the appellant has a realistic as opposed to a fanciful prospect of success in its appeal. A realistic prospect is one that carries some degree of conviction and one that is more than merely arguable. In my view the appellant has no such realistic prospect of success. It was obliged to account for corporation tax on the basis of accounts which had been compiled in accordance with UK generally accepted accounting practice. This was the case for the accounting period ended 28 February 2018 in which House 4 was sold. FRS 105 was the relevant accounting standard and obliged the appellant to account during that period on accruals basis. This meant that the only costs which could be deducted from the proceeds of sale of House 4 were those incurred on House 4. The discovery assessment reflects this. The appellant has no reasonable prospect of succeeding in the appeal.

DECISION

22. Accordingly, I allow the application and direct that the appeal is struck out with immediate effect.

23. I understand that, separately from the appeal, HMRC have assessed the appellant to corporation tax for other tax years, and the appellant has appealed against those assessments. Those matters are not before me today, and I leave it to the parties to decide how this decision affects those appeals.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

24. The appellant has the right to apply for the proceedings to be reinstated but such an application must be (a) in writing, (b) supported by reasons and include an explanation for the non-compliance and (c) received by the tribunal within 28 days after the date this decision was sent. The appellant also has the right, if the appellant believes the decision striking out the appeal contains an error of law, to apply for permission to appeal, but such an application must be (a) in writing (b) identify the alleged error of law and (c) be received by the tribunal no later than 56 days after the date this decision was sent. Neither application is granted automatically.

NIGEL POPPLEWELL
TRIBUNAL JUDGE

Release date: 12th October 2023

APPENDIX

The F-tT Rules

1. The relevant Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the "**Rules**") are Rules 2, 5 and 8:

2. Rule 2(3) requires me to give effect to the over-riding objective when exercising any power under the Rules. The over-riding objective, as set out in Rule 2(1), is as follows:

> (1) "The overriding objective of these Rules is to enable the Tribunal to deal with cases fairly and justly".

3. Rule 5 deals with case management powers:

> **"5. Case management powers**
>
> (1) Subject to the provisions of the 2007 Act and any other enactment, the Tribunal may regulate its own procedure.
>
> (2) The Tribunal may give a direction in relation to the conduct or disposal of proceedings at any time, including a direction amending, suspending or setting aside an earlier direction.
>
> (3) In particular, and without restricting the general powers in paragraphs (1) and (2), the Tribunal may by direction—
>
> (a) extend or shorten the time for complying with any rule, practice direction or direction, unless such extension or shortening would conflict with a provision of another enactment setting down a time limit;
>
> (b) consolidate or hear together two or more sets of proceedings or parts of proceedings raising common issues, or treat a case as a lead case (whether in accordance with rule 18 (lead cases) or otherwise);
>
> (c) permit or require a party to amend a document;
>
> (d) permit or require a party or another person to provide documents, information or submissions to the Tribunal or a party;
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> (e) deal with an issue in the proceedings as a preliminary issue;
>
> (f) hold a hearing to consider any matter, including a case management hearing;
>
> (g) decide the form of any hearing;
>
> (h) adjourn or postpone a hearing;
>
> (i) require a party to produce a bundle for a hearing;
>
> (j) stay (or, in Scotland, sist) proceedings;

(k) transfer proceedings to another tribunal if that other tribunal has jurisdiction in relation to the proceedings and, because of a change of circumstances since the proceedings were started—

(i) the Tribunal no longer has jurisdiction in relation to the proceedings; or

(ii) the Tribunal considers that the other tribunal is a more appropriate forum for the determination of the case;

(l) suspend the effect of its own decision pending the determination by the Tribunal or the Upper Tribunal, as the case may be, of an application for permission to appeal, a review or an appeal."

4. Rule 8 deals with strike out:

"8. Striking out a party's case

(1) The proceedings, or the appropriate part of them, will automatically be struck out if the appellant has failed to comply with a direction that stated that failure by a party to comply with the direction would lead to the striking out of the proceedings or that part of them.

(2) The Tribunal must strike out the whole or a part of the proceedings if the Tribunal—

(a) does not have jurisdiction in relation to the proceedings or that part of them; and

(b) does not exercise its power under rule 5(3)(k)(i) transfer to another court or tribunal) in relation to the proceedings or that part of them.

(3) The Tribunal may strike out the whole or a part of the proceedings if—

(a) the appellant has failed to comply with a direction which stated that failure by the appellant to comply with the direction could lead to the striking out of the proceedings or part of them;

(b) the appellant has failed to co-operate with the Tribunal to such an extent that the Tribunal cannot deal with the proceedings fairly and justly; or

(c) the Tribunal considers there is no reasonable prospect of the appellant's case, or part of it, succeeding.

(4) The Tribunal may not strike out the whole or a part of the proceedings under paragraphs (2) or (3)(b) or (c) without first giving the appellant an opportunity to make representations in relation to the proposed striking out.

(5) If the proceedings, or part of them, have been struck out under paragraphs (1) or (3)(a), the appellant may apply for the proceedings, or part of them, to be reinstated.

(6) An application under paragraph (5) must be made in writing and received by

the Tribunal within 28 days after the date that the Tribunal sent notification of the striking out to the appellant.

(7) This rule applies to a respondent as it applies to an appellant except that—

(a) a reference to the striking out of the proceedings must be read as a reference to the barring of the respondent from taking further part in the proceedings; and

(b) a reference to an application for the reinstatement of proceedings which have been struck out must be read as a reference to an application for the lifting of the bar on the respondent taking further part in the proceedings.

(8) If a respondent has been barred from taking further part in proceedings under this rule and that bar has not been lifted, the Tribunal need not consider any response or other submissions made by that respondent and may summarily determine any or all issues against that respondent".

Strike out – case law

5. The legal principles which I must consider have been neatly set out in the Upper Tribunal in *The First De Sales Limited Partnership and others v HMRC* [2018] UKUT 396:

"Approach to applications to strike out - legal principles

31 At [30] of the decision, the judge applied the summary of principles set out by the Upper Tribunal in *HMRC v Fairford Group plc* [2014] UKUT 329; [2015] STC 156 ('*Fairford Group plc'*). The Upper Tribunal held (at [41]) that:

"In our judgment an application to strike out in the FTT under r 8(3)(c) should be considered in a similar way to an application under CPR 3.4 in civil proceedings (whilst recognising that there is no equivalent jurisdiction in the FTT Rules to summary judgment under Pt 24). The tribunal must consider whether there is a realistic, as opposed to a fanciful (in the sense of it being entirely without substance), prospect of succeeding on the issue at a full hearing, see *Swain v Hillman* [2001] 1 All ER 91 and *Three Rivers* [2000] 3 All ER 1 at [95], [2003] 2 AC 1 per Lord Hope of Craighead. A 'realistic' prospect of success is one that carries some degree of conviction and not one that is merely arguable, see *ED & F Man Liquid Products Ltd v Patel* [2003] EWCA Civ 472, [2003] 24 LS Gaz R 37. The tribunal must avoid conducting a 'mini-trial'. As Lord Hope observed in *Three Rivers*, the strike-out procedure is to deal with cases that are not fit for a full hearing at all".

32. It was common ground that the application should be considered in a similar way to an application under CPR 3.4 in civil proceedings (whilst recognising that there is no equivalent jurisdiction in the FTT Rules to summary judgment under Part 24).

33. Although the summary in *Fairford Group Plc* is very helpful, we prefer to apply the more detailed statement of principles in respect of application for summary judgment set out by Lewison J, as he then was, in *Easyair Ltd (t/a Openair) v Opal Telecom Ltd* [2009] EWHC 339 (Ch) at [15]. This was subsequently approved by the Court of Appeal in *AC Ward & Sons v Caitlin Five Limited* [2009] EWCA Civ 1098. The parties to this

appeal did not suggest that any of these principles were inapplicable to strike out applications.

> "i) The court must consider whether the claimant has a 'realistic' as opposed to a fanciful prospect of success: *Swain v Hillman* [2001] 1 All ER 9;
>
> ii) A 'realistic' claim is one that carries some degree of conviction. This means a claim that is more than merely arguable: *ED & F Man Liquid Products v Patel* [2003] EWCA Civ 472 at [8];
>
> iii) In reaching its conclusion the court must not conduct a 'mini-trial': *Swain v Hillman*;
>
> iv) This does not mean that the court must take at face value and without analysis everything that a claimant says in his statements before the court. In some cases it may be clear that there is no real substance in factual assertions made, particularly if contradicted by contemporaneous documents: *ED & F Man Liquid Products v Patel* at [10];
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> v) However, in reaching its conclusion the court must take into account not only the evidence actually placed before it on the application for summary judgment, but also the evidence that can reasonably be expected to be available at trial: *Royal Brompton Hospital NHS Trust v Hammond (No 5)* [2001] EWCA Civ 550;
>
> vi) Although a case may turn out at trial not to be really complicated, it does not follow that it should be decided without the fuller investigation into the facts at trial than is possible or permissible on summary judgment. Thus the court should hesitate about making a final decision without a trial, even where there is no obvious conflict of fact at the time of the application, where reasonable grounds exist for believing that a fuller investigation into the facts of the case would add to or alter the evidence available to a trial judge and so affect the outcome of the case: *Doncaster Pharmaceuticals Group Ltd v Bolton Pharmaceutical Co 100 Ltd* [2007] FSR 63;
>
> vii) On the other hand it is not uncommon for an application under Part 24 to give rise to a short point of law or construction and, if the court is satisfied that it has before it all the evidence necessary for the proper determination of the question and that the parties have had an adequate opportunity to address it in argument, it should grasp the nettle and decide it. The reason is quite simple: if the respondent's case is bad in law, he will in truth have no real prospect of succeeding on his claim or successfully defending the claim against him, as the case may be. Similarly, if the applicant's case is bad in law, the sooner that is determined, the better. If it is possible to show by evidence that although material in the form of documents or oral evidence that would put the documents in another light is not currently before the court, such material is likely to exist and can be expected to be available at trial, it would be wrong to give summary judgment because there would be a real, as opposed to a fanciful, prospect of success. However, it is not enough simply to argue that the case should be allowed to go to trial because something may turn up which would have a bearing on the question of construction: *ICI Chemicals & Polymers Ltd v TTE Training Ltd* [2007] EWCA Civ 725"".