Neutral Citation: [2023] UKFTT 00351 (TC)

Case Number:TC08778

FIRST-TIER TRIBUNAL
TAX CHAMBER

[By remote video hearing]

Appeal reference: TC/2016/04233

INCOME TAX AND NICs – payments to a remuneration trust – whether contributions to trust made wholly and exclusively for the purposes of the trade – whether accounts in accordance with UK generally accepted accounting practice ('UK GAAP') – whether the arrangements were a sham – held that contributions to trust and associated fees were not deductible, accounts not in accordance with UK GAAP and the arrangements were a sham – appeal dismissed

Heard on: 25 January 2022
Judgment date: 21 March 2023

Before

TRIBUNAL JUDGE KIM SUKUL

Between

MARK NORTHWOOD

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Harriet Brown, counsel, instructed by Griffin Law

For the Respondents: Hui Ling McCarthy KC and Barbara Belgrano, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. The hearing was conducted over 5 days. The 3-day hearing commenced on 25 January 2022 and the Tribunal previously heard testimony from Mr Northwood on 24 and 25 September 2021, due to medical reasons. With the consent of the parties, the form of the hearing was video, conducted on the Tribunal's Video Hearing Service platform. 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.

2. The documents to which I was referred were contained within the core PDF bundle (1,617 pages), supplementary PDF bundle (1,297 pages) and authorities PDF bundle (1,771 pages). I also had the benefit of skeleton arguments and various written submissions from both parties, in addition to transcripts of the 5 hearing days (totalling 820 pages).

APPEAL

3. Mr Northwood's appeal to the First-tier Tribunal ('FTT') is against closure notices issued by the Respondents ('HMRC') on 1 December 2015 amending his income tax returns, for the years ended 5 April 2010, 5 April 2011, 5 April 2012 and 5 April 2013 to disallow the deductions claimed in relation to contributions to a renumeration trust ('RT'). The amendments give rise to additional amounts of income tax and national insurance contributions ('NICs') totalling £999,755.81.

4. Mr Northwood's case is that making contributions to the RT had the effect of reducing the taxable profits from his self-employed dentistry business and thus his liability to income tax and NICs. HMRC disagree and amended Mr Northwood's tax returns to remove the deduction. The appeal is against HMRC's amendments.

5. For the reasons set out below, I dismiss the appeal.

BACKGROUND

6. Mr Northwood qualified as a dental surgeon in 1988 and has conducted his orthodontist practice for many years as a sole trader.

7. In 2009, Mr Northwood entered into discussions with Foy Wealth Ltd ('Foy') and Baxendale Walker ('BW') regarding the establishment of a remuneration trust.

8. On 17 September 2009, BW LLP provided Mr Northwood with an engagement letter, which states:

> "Remuneration Trust Arrangements ("the Arrangements")
>
> Thank you very much for instructing this Firm to act for you in this matter. In the interests of best client relations, we are writing to you at the beginning of this matter to advise you of certain professional issues.
>
> Money Laundering and Know Your Client Requirements
>
> In order to satisfy the requirements of the Money Laundering Regulation: 2007, we have to be satisfied as to the identity of our clients before we can start acting for you. In this case, we are required to obtain the information specified in the Appendix to this letter.
>
> So far as offshore trustee services may be required, the relevant money laundering due diligence requirements will also need to be met. They are substantially met by our own due diligence requirements. Please help us by providing this information as soon as you can.

Responsibility for conduct of the matter

One of our Case Managers will be allocated to assume direct responsibility for dealing with this case. Other fee earners within the Firm may be called upon to assist from time to time. The relevant Case Manager will contact you directly.

Complaints

If you have any queries or concerns regarding our work for you, you should raise these, in the first instance, with the Case Manager dealing with your matter. He or she will be keen to resolve your concerns as soon as possible.

Work to be performed

We have been instructed by you to perform the following work:

1 to advise in relation to the implementation of the Arrangements;

2 to take your detailed instructions, including:

2.1 reviewing all relevant documents;

2.2 researching any matters of taxation, company, trusts, employment, or pension law which are relevant to the circumstances;

3 to prepare a detailed Memorandum of Advice for you on these matters;

4 to assist with the all legal documentation relevant to the arrangements;

5 (if appropriate) to recommend and liaise with Channel Island Trustees to facilitate the relevant transactions.

We do not provide investment advice and are not liable for any loss arising from any client or trustee or other investment

MINERVA

The Arrangements in relation to which we are instructed to advise will be based upon the relevant Plan issued by MINERVA. The relationship between us and MINERVA is set out in an Appendix to this letter, as is our Professional Liability Statement Please read these carefully.

In order to progress your case efficiently we will need to liaise with MINERVA and its Business Introducers. By signing and returning this letter, you authorise us to disclose to such persons such information about these matters as we consider necessary from time to time.

Fees

Baxendale Walker LLP fees are £10,000.00 plus VAT, MINERVA fees are 10% for each and every contribution made to the Trust. Separate fees are, as stated payable to this Firm and to MINERVA.

All fees should be paid direct to this Firm and we will account to MINERVA for the appropriate monies. Our banking details are set out below. The fees of this Firm are subject to VAT. MINERVA fees are not subject to VAT.

On Account: £10,000.00 plus VAT ls payable on account and may be billed by us immediately upon receipt.

Introducer Expenses: I confirm expenses to Foy Wealth will be £3,500.00.

The Balance and MINERVA Fees: The balance of fees and disbursements due to this Firm will be billed to you on completion of the work detailed above and must be paid prior to the execution of the relevant completion documents. Our fees are otherwise payable within 7 days of issue of a pro-forma invoice.

After 30 days interest will be due at the rate of 8% . The Minerva Fees are also payable upon completion, unless you are utilising the Minerva Bond. In such case, payment of the Minerva Fee will occur in consequence of completion of such Bond financing. A Minerva fee of 10% is due upon each and every contribution of new value to a Minerva Trust (but not any growth In settled value).

Further Work: Any further work which you require will be invoiced to you at our respective hourly rates on a monthly basis. Paul Baxendale-Walker's fees are charged on an hourly basis of £1,000 plus disbursements and VAT. The fees of other Case Managers are charged on an hourly basis of £600 plus disbursements and VAT.

Exclusive Terms: By signing this document you confirm that the terms of your agreement with Baxendale Walker LLP are limited to the matters stated herein. You confirm that your contract for services, including but not limited to the provision of information and advice is exclusively with Baxendale Walker LLP and not with any member, employee, consultant or representative of Baxendale Walker LLP. In consideration of Baxendale Walker LLP agreeing to provide you with any advice or assistance, you hereby covenant with Baxendale Walker LLP not to seek by litigation or otherwise to impose legal liability in tort or otherwise on any person save Baxendale Walker LLP in respect of any conduct or matter arising out of any acts or omissions (whether actual or alleged) undertaken by any person or persons other than Baxendale Walker LLP.

Engagement

You are requested to sign and return your counterpart of this letter. Whether or not you do so, you will be liable to pay our fees on the above stated terms for any work which is actually performed by us upon your request in relation to this matter.

Any counter offer by you of the terms upon which the agreement for the provision of our services to you is to be concluded must be provided in writing by you to us prior to the commencement of any such work."

9. An appendix to the engagement letter states:

"MINERVA is a separate business of BW LLP, which sells and markets wealth protection strategies devised by us. MINERVA is owned by a Jersey purpose trust, the purposes of which are to facilitate and advance the businesses of MINERVA and BW LLP. MINERVA does not provide investment advice.

BW LLP takes full responsibility for ensuring that any MINERVA Plan is technically correct at the time of use and that it is implemented correctly. In the event of error in the Plan or our implementation advice all fees up to £2 million for each case are repayable under our professional indemnity insurance policy.

BW LLP is authorised to engage clients for MINERVA by reference to their standard Plan sale terms. BW LLP is also authorised to pay commissions to Business Introducers on behalf of MINERVA. BW LLP takes a 10% fee for the sale of a MINERVA Plan. BW LLP charges our professional fees for advising upon the detailed implementation of these Plans. Our unrivalled expertise, experience and separate business relationship with MINERVA allows us to provide a unique Total Fee Package. The Package depends upon precise circumstances Pricing is simply a percentage of the Tax Value from which our advice, together with the appropriate Plan provides liberation.

> Your BW LLP engagement letter is issued under standard terms and conditions, and guarantees the fixed advisory fee and Plan fee quoted, together with repayment thereof in the event of failure."

10. Mr Northwood signed the engagement letter on 23 September 2009.

11. On 9 October 2009, BW provided Mr Northwood with a Report to the Business ('the Report'). The summary within the Report states:

> "3.1 The Sole Trader has instructed us to advise on the legal implications of the establishment by the Business of a cash funded Remuneration Trust.
>
> 3.2 For the purpose of this Report, we have reviewed the concept of a cash funded Remuneration Trust and its applicability to the circumstances of the Business.
>
> 3.3 The Sole Trader wishes to pay or provide benefits to its present suppliers and customers and future Employees, together with other classes of potential beneficiary.
>
> 3.4 The Sole Trader's sole purpose in so doing is the discharge of its commercial liabilities to make payments to or for the benefit of contractors or customers and others with whom he has a commercial relationship. The Sole Trader has no legal liability to such persons in respect of such contributions, i.e. under a contract or otherwise. The Sole Trader does not wish to do anything which might have the effect of evidencing that legal liability to make such payments has arisen.
>
> 3.5 In our Opinion, a Remuneration Trust (modified in accordance with the following recommendations) provides the appropriate type of trust vehicle for the achievement of the Business' commercial objectives.
>
> 3.6 The Sole Trader derives no tax advantage from the Trust or any other means of payment or provision, of such benefits, since direct payments would themselves be fully deductible in computing the Sole Trader's taxable profits. The taxation liability arising from any particular Investment or distribution of Trust funds depends upon all the relevant circumstances, none of which the Business has any power to prescribe or procure.
>
> 3.7 Therefore, the establishment and funding of the Trust cannot in our Opinion properly be characterised as constituting "tax avoidance". The High Court of Justice has ruled that the use of remuneration Trusts does not constitute tax avoidance: *MacDonald (Inspector of Taxes) v Dextra Accessories Ltd and Others* (2003). HM Revenue & Customs accepts and in any event is bound by this ruling."

12. With regard to establishing the RT, the Reports states:

> "5.1 The Sole Trader will need to quantify the commercial liabilities incurred by reason of the Business' trade during the relevant accounting period. The Sole Trader will then need to consider whether a trust of the kind discussed in this Report will provide a satisfactory commercial vehicle for the discharge of those liabilities. The Sole Trader is entitled to rely on this Report, together with any appropriate consultancy or professional advice, in reaching his conclusions on these matters.
>
> 5.2 The Sole Trader will need to determine how the Trust will be used to implement the incentive program. The Business must then pass appropriate Written Resolutions.
>
> 5.3 The appropriate Deed of Trust is executed by the Sole Trader and the Trustees: the Sole Trader will need to choose the trustees that he wants.

> 5.4 The Sole Trader then begins paying cash contributions to the Remuneration Trust trustees.
>
> 5.5 The Sole Trader should then inform appropriate classes of discretionary beneficiary of the existence of the Remuneration Trust, in the usual manner that the Sole Trader conveys information of importance to such persons.
>
> 5.6 The Sole Trader may from time to time indicate to the trustees how he would like them to utilise the trust funds: for example, by paying a bonus to certain providers. The trustees must always however exercise their own discretion in these matters.
>
> 5.7 The Sole Trader is entitled to provide other information to the Trustees. The Trustees are assisted in the performance of their fiduciary duties by being made aware of the Sole Trader's commercial expectations for the incentive program."

13. The Mark Northwood Remuneration Trust Deed, dated 30 November 2009, describes Mr Northwood as "the Founder" and Bay Trust International Limited ('Bay') as "the Original Trustees". The Deed refers to the Founder having provided £100 to the Trustees to be held and applied subject to and in accordance with the RT. The Declaration of Trust states:

> "2.1 Subject as aforesaid and subject to Clause 10 hereof the Trustees shall during the Trust Period hold the Trust Fund UPON TRUST to apply the income and capital thereof to or for the benefit of all or any one or more exclusively of the others or other of the Beneficiaries in such shares and in such manner generally as the Trustees shall In their absolute discretion think fit PROVIDED THAT the Trustees may if they in their absolute discretion think fit accumulate the whole or any part of the income of the Trust Fund by investing the same and the resulting income thereof in any investments hereby authorised and adding the accumulations to the capital of the Trust Fund."

14. The "Beneficiaries" are defined as:

> "from time to time the wives husbands widows widowers children step-children and remoter issue of past and present Providers and the spouses and former spouses (whether or not remarried) of such children and remoter issue and also means from time to time future Providers and the wives husbands widows widowers children step-children and remoter issue off future Providers and the spouses and former spouses (whether or not remarried) of such children and remoter issue and "Beneficiary" has a corresponding meaning PROVIDED THAT no Excluded Person shall be a Beneficiary AND FURTHER PROVIDED THAT the Trustee shall not have power under the trusts hereunder to provide and shall not (whether directly or indirectly) provide any benefit to or for any Excluded Person and nor Shall the Trustee participate in any bust, scheme or arrangement which is an 'employee benefits scheme' for the purposes of Schedule 24 Finance Act 2003, or which participation would have the consequence that the provisions of Schedule 24 Finance Act 2003 apply so as to restrict the deductibility for corporation tax purposes of Founder contributions to the trusts hereof AND FURTHER PROVIDED THAT the Trusts hereunder shall not have effect so as to constitute an arrangement such that the Trust Fund from time to time falls to be accounted for as an asset of the Founder."

15. A "Provider" is defined as:

> "(i) a person who provides or has provided or may in future provide to the Founder service or services or custom or products or finance (save for items of a capital nature); and (ii) a person who provides or has provided or may in

future provide finance to the Trustees or any manager from time to time of the Trust Fund."

16. An "Excluded Person" is defined as: "... any of the persons named in Schedule 2 to this Deed". Schedule 2 includes the Founder, namely Mr Northwood, and any person connected with the Founder.

17. The Trust provides:

> "The Firm shall have the exclusive power (which shall be a fiduciary power) to authorise, instruct and oblige the Trustees from time to time to discharge any invoice in respect of any Service Fee and such power shall be exercisable by notice in writing by fax or post from a Partner or Principal in the Firm to the Trustees and the opinion of such Partner or Principal as to whether a fee constitutes a Service Fee shall be conclusive."

18. The "Firm" is defined as "Baxendale Walker LLP" and "Service Fee" is defined as "any fee which is properly payable out of the Trust Funds in respect of professional, investment or other services provided to the Trustee in respect of the Trusts of this Deed".

19. On 27 November 2009, Mr Northwood signed a document entitled "Resolution (A) Mr Mark Northwood Written Resolutions of the Sole Trader" ('Resolution A') which states that:

> "1. It is resolved that the Business make contributions to a scheme established under irrevocable trust ("the Scheme") for the purpose off funding the provision of discretionary benefits to providers of service, services, products and custom to the business and their respective wives, widows and dependents. It is also resolved that providers of finance to the Trust and their respective wives, widows and dependents be included as discretionary beneficiaries. It is resolved that the initial establishment cost of the Scheme and the amount required to place the Scheme in funds is £100. It is further noted that the establishment of the Scheme provides a means for the trade of the Business to thereby be benefited.
>
> 1.1 It is also noted that the Scheme is not a pension scheme and is prohibited from paying relevant benefits.
>
> 2. The detailed Responses which l have agreed to a Questionnaire provided by my professional advisers have been reviewed. The Questionnaire and Responses are attached to this Resolution. It is resolved that those Responses continue accurately to reflect the purpose of the Business in establishing the proposed Scheme.
>
> 3. It is concurred that contributions by the Business for the year ended 31st March 2010 and subsequent years may be made on a weekly, monthly, annual or other periodic basis as may be appropriate for the commercial cashflow circumstances of the Business. It is noted that such periodic contributions would reflect part of the economic cost to the Business of earning its profits for that period. It is noted that at the end of each fiscal year, the total contributions for that year will be summarised. I have compiled the list of persons who have provided service, services, products, custom or finance to the Business in the last accounting period, which is attached to this Resolution ("the Providers List').
>
> 4. It is resolved that such amount of contribution for the year ended 31st March 2010 and subsequent years will be paid wholly or partly out of revenue income of the Business.

> 5. It is resolved that an appropriate form of trust deed for the Scheme ("the Deed") is held by Bay Trust International Limited, who are the proposed original trustees of the Scheme ("the Trustees"}.
>
> 6. After due and careful consideration it was resolved that:
>
> 6.1 the Deed be adopted as the definitive trust deed of the Scheme;
>
> 6.2 the persons named as the trustees in the Deed are suitable persons to be Trustees of the Scheme;
>
> 6.3 I should execute the said Deed for and on behalf of the Business;
>
> 6.4 in respect of-the fiscal year ended 31st March 2010, a contribution of £100,000 (being the first of a series of such contributions) be paid to the said Trustees of the Scheme to be held on the trusts of the Scheme;
>
> 6.5 The Trustees be provided with a copy of this Resolution and the attached Providers List."

20. A list of "Persons who had provided service, services, products, custom or finance to the Business of Mr Northwood in the last fiscal year" is appended to Resolution A, where four business names and addresses are listed.

21. Resolution A also has appended to it a completed questionnaire ('the Questionnaire'), which states:

> "1. Has the trade been conducted in such a way as to place a commercial obligation on the Business to provide benefits for consultants and other suppliers? Yes ... but the Business does not want to recognise any liability to pay or provide benefits to any particular person, because that could create an actual legal liability.
>
> 2. Has the trade been conducted in such a way as to place a commercial obligation on the Business to provide benefits for customers? Yes ... but the Business does not want to recognise any liability to pay or provide benefits to any particular person, because that could create an actual legal liability.
>
> 3. Is the Sole Trader taking independent professional advice on the creation of the incentive arrangement? Yes.
>
> 4. How will the Sole Trader choose the trustees? By recommendation/meeting them.
>
> 5. It is intended that the trust be discretionary. This means that no beneficiary can order the trustees to make a payment to him. Why does the Sole Trader think this is a good idea? Because the obligation to contribute funds arises from commercial, but not legal liability. If fixed benefits were provided, this could constitute an admission of a specific legal liability upon the Business to pay particular persons. By putting monies into a trust, the Business discharges its commercial liability and does not have to take any further action. It allows time for the trustees to consider the provision of specific benefits to specific persons.
>
> 6. Does the Sole Trader consider that it is possible to allocate any or all of the contribution to any particular beneficiary or beneficiaries or that it is desirable to do so? Why? The Business does not want to spend its expensive management time in determining which specific person should get what. The discretionary trust allows each potential beneficiary to make a case to the trustees for the receipt of a benefit and for the Trustees to determine what benefits should be paid out.

> 7. The discretionary trust will prohibit the refund of contributions to the Business. Why does the Sole Trader think this is a good idea? Because otherwise the Business could be said to have not in reality discharged its commercial liabilities.
>
> 8. Does the Sole Trader intend to use a fixed formula for calculating contributions (e.g. 1/3 of profits)? or does he intend to look at the performance of the Business and try to reflect that in the amount of contributions made? The Sole Trader will consider the performance of the Business.
>
> 9. How and when will potential beneficiaries be informed? That is the Trustees responsibility. The Business will provide them with a list of those who have provided service, services and custom to the Business."

22. On 11 November 2009, Marhel Management Limited ('MML') was incorporated and registered in the UK, with Mr Northwood and Mrs Northwood (Mr Northwood's wife) appointed as directors and shareholders.

23. On 1 December 2009, in a document entitled "Appointment of Delegated Manager and Custodian: The Mark Northwood Remuneration Trust", Bay delegated the "execution or exercise of all or any of the Trust's powers and discretions conferred upon it as Trustee as regards the management and custody of the Trust Fund comprised therein". On the same date DHN Holdings Ltd, a company registered in Belize, and MML entered into a Fiduciary Services Agreement whereby MML, as the fiduciary, "shall during the Period of Appointment hold the Property and the income and capital thereof and all accumulations thereto UPON TRUST absolutely for the Principal and subject to the power to borrow against the Property and to invest the proceeds of such borrowing".

24. On 22 January 2010, Mr Northwood signed a Memorandum of Wishes which states:

> "As the Founder of the Trust, I am writing to you to request that you give your consideration to the following matters. I appreciate that you must exercise your own discretion in all such matters and I hope that you will find the following information of use in exercising such discretion.
>
> I would like the Trustees to give consideration to advancing a loan of £150,000 to Mark Northwood upon commercial terms to be agreed, for the purposes of general investment.
>
> I reaffirm my understanding that you are in no way bound to follow my wishes in this or in any other respect."

25. Loans made (totalling £525,000) by MML to Mr Northwood during the year ending 5 April 2010 were for £150,000 on 25 January 2010, £150,000 on 29 January 2010, £105,000 on 5 February 2010 and £120,000 on 26 March 2010.

26. The initial contribution to the Trust of £450,000 was on the basis that £150,000 was transferred to the Trust and then loaned to Mr Northwood, who then used that £150,000 to contribute a further £150,000. This process was repeated so that the Trust had received £150,000 in cash and £300,000 in the form of a promise to repay existing debts for the amounts loaned.

27. Mr Northwood claims that the following total contributions were made to the Trust in the relevant years:

(a) In the year ended 31 March 2010: £570,000

(b) In the year ended 31 March 2011: £498,787

(c) In the year ended 31 March 2012: £500,000

(d) In the year ended 31 March 2013: £555,000

28. On 10 May 2010, Mr Northwood wrote to Bay as follows:

> "As the Founder of the Trust, l am writing to request that you give your consideration to the following matters. I appreciate that you must exercise your own discretion in such matters and I hope you find the following information of use.
>
> I would like the Trustee to give consideration to transfer the trust assets to be managed by the FIDCO, Marhel Management Limited, upon commercial terms to be agreed, for the purposes of general investment
>
> I reaffirm our understanding that you are in no way bound to follow our wishes in this or in any other respect. If you are in agreement, I should be grateful if you would forward the funds to the bank account as follows:"

29. Loans for subsequent years were, £335,000 in the year ended 31 March 2011, £75,000 in the year ended 31 March 2012 and £470,000 in the year ended 31 March 2013. All loans were for a term of ten years and one day, unsecured, and issued at a rate of 2 per cent above LIBOR.

30. Mr Northwood's financial statements for each of the accounting periods under appeal are said to have been compiled on a basis which enables profits to be calculated in accordance with generally accepted accounting practice ('GAAP').

LEGISLATION

31. Section 25(1) of the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA 2005') provides that:

> "The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes."

32. Section 34(1) ITTOIA 2005 provides that:

> "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…"

33. These provisions apply to professions and vocations as they apply to trades under sections 24 and 32 ITTOIA 2005.

GROUNDS OF APPEAL

34. Mr Northwood's stated grounds of appeal are:

> "1. The contributions to the Remuneration Trust for the periods are in keeping with generally accepted accounting practice (GAAP). The accounting for the contributions is correct. The payments form a valid expense of the business and are deductible for tax purposes accordingly.
>
> 2. The expenditure was incurred wholly and exclusively for the purposes of the trade (see Section 34 Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005").
>
> 3. HMRC's contention that there was never any intention for beneficiaries to benefit from the contributions to the trust is incorrect.
>
> 4. The establishment and contributions to the trust are not part of a "tax scheme" and do not comprise tax avoidance.
>
> 5. HMRC does not offer any explanation on why it considers that Marhel Management Limited did not act as a genuine fiduciary. We appeal on the

basis that we do not know HMRC's reasons for adopting this stance, it has reached a speculative conclusion on the basis of an imprecise rationale using terminology that would appear to have no practical or legal meaning. We confirm that Marhel Management Limited has acted entirely appropriately."

35. Mr Northwood contends that his letter dated 15 December 2015 also forms part of his grounds, which states:

> "The contributions are in keeping with both generally accepted accounting practise and were incurred wholly and exclusively for the purposes of the trade.
>
> FRS 12 is not applicable and therefore the definition does not come into application.
>
> The purpose of FRS 12 is "to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets". Of these, the only term that would apply to sums gifted to a commercial incentives trust is that of provisions. A provision is "a liability that is of uncertain timing or amount, to be settled by the transfer of economic benefits." Clearly where a sum has already been settled it is no longer of "uncertain timing or amount" and cannot fall within this definition. In the context of FRS 12, it therefore follows that obligations in respect of expenses actually paid during the accounting period are indeed irrelevant. It may also assist for you to refer to the comments of Sir David Tweedie on introduction of FRS 12 to emphasise the extent to which this is inapplicable.
>
> The International Accounting Standards Board Conceptual Framework does however state that expenses represent "decreases in economic benefits during the accounting period in the form of outflows or depletion of assets or incurrence of liabilities that result in decreases in equity". Remuneration Trust contributions would clearly fall within this definition. In particular, the conceptual framework is helpful given the emphasis you place on FRS 12 and the fact that this was derived from IAS 37, drafted under the principles set out in the framework.
>
> Regarding the issue of accounting treatment for trust contributions, it may also assist for you to refer to the accounting treatment discussed in the case of *JT Dove Ltd v HMRC* [2011] UKFTT 16 (TC) and the accounting treatment described therein. The purpose of accounting standards is to provide a true and fair view. The contributions into trust are placed irrevocably out with the control of the business. The sums have left the business and are no longer able to be utilised. In each case the expense was incurred wholly and exclusively for the purposes of the trade. In these circumstances the only appropriate course is a debit to the Profit and Loss account. This is vital to ensure that a true and fair view is reflected.
>
> The trust is long term in nature and is to benefit the business over said period. When seen in this appropriate context, we submit that the fact of whether any distributions have been made from the trust (in the form of benefits of otherwise) as at the present date is entirely immaterial.
>
> You make reference to evidence indicating that "the arrangements were contrived for tax avoidance purposes". You are incorrect in this assertion…
>
> You assert that the fiduciary "did not act as a genuine fiduciary"... We appeal on the basis that you have reached a speculative conclusion on the basis of imprecise rationale and terminology that would appear to have no practical or legal meaning. It can in any case be confirmed that the fiduciary has acted

> entirely appropriately and the formal basis upon which this can be challenged is not at all evident.
>
> We similarly reserve the right to extend or add to the arguments that are presented here. It can be confirmed that the "reality of the arrangements" conforms with the documents seen."

ISSUES

36. The issue between the parties is whether contributions to the RT, together with any associated fees, are deductible in calculating Mr Northwood's taxable profits. I agree with HMRC's submission that there are four sub-issues:

(1) Whether contributions to the RT should have been recognised as an expense in the accounts under UK GAAP;

(2) If the contributions should have been recognised as an expense under UK GAAP, whether the expense was incurred;

(3) Whether contributions to the RT were wholly and exclusively for the purposes of the trade;

(4) Whether a deduction for the associated fees can be claimed.

37. The Tribunal is also asked to consider HMRC's pleading on the basis of the sham doctrine, that Mr Northwood intended, by virtue of the scheme documentation, to make things appear other than they were.

38. Although, on the basis of my conclusions, it is unnecessary to consider all issues to determine the appeal, I have nonetheless addressed all issues for completeness and to set out my conclusions on other issues, if I am wrong on any particular issue.

PRELIMINARY MATTERS

FRS 18

39. HMRC made an application the day before the hearing to be permitted to take Mr Northwood's expert accountancy witness, Mr Powrie, to FRS 18 (which requires accounting policies to be adopted to give a true and fair view) during cross-examination. The grounds for the application were that Mr Powrie's relies in his report on all the rules and principles applying to the preparation of accounts but has not mentioned FRS 18 or explained how his evidence is consistent with FRS 18. Ms Belgrano submitted that although HMRC were not obliged to give advance notice of the lines of questioning which they intended to pursue (see *Ingenious Games LLP and others v HMRC* [2015] UKUT 105 (TCC) at [65]), Mr Powrie should have the opportunity to address this point in oral evidence and he will be assisted by having FRS 18 available.

40. Ms Brown strongly opposed the application, arguing that it amounted to adducing new evidence and an amendment to HMRC's statement of case, as well as being against the interests of justice.

41. I do not agree with Ms Brown's submissions. I consider the rules and principles applying to the preparation of accounts to be in evidence, whether referred to specifically or not, by virtue of Mr Powie's report. Further, as FRS 18 appears to be relevant, I consider that it should be admitted in the absence of any compelling reason to the contrary (see *Mobile Export 365 LTD v HMRC* [2007] EWHC 1737 (Ch) at [20]). I also do not agree that allowing the application seeks to amend HMRC's statement of case. Part of HMRC's case is that the accounts were not prepared in accordance with GAAP and HMRC's statement of case sets out their position on whether the RT transfers expense is in accordance with GAAP. Although their statement of case does not refer specifically to FRS 18, I do not consider its inclusion to

fundamentally alter HMRC's basic position, as contended by Ms Brown, such that an amendment to the statement of case is necessary.

42. On the question of whether it is in the interest of fairness and justice to allow the application, Ms Brown makes reference to HMRC previously making a number of applications at short notice that have disrupted preparation and argues that is a much more significant factor in the case of an individual appellant, with limited resources and support, than it is for HMRC. In respect of this application, I accept Ms Belgrano's explanation that the late timing of the application was unavoidable due to the issue arising whilst preparing for cross-examination. On balance, I consider the potential prejudice to HMRC from refusing to allow relevant cross-examination to outweigh the potential prejudice to Mr Northwood's case by the lateness of the application. I consider it to be in the interests of fairness and justice to allow the cross-examination and the application is therefore granted.

Pleading Sham

43. In their skeleton argument dated 11 January 2022, HMRC stated: "In the light of the Appellant's evidence, as it emerged during cross-examination, HMRC advance a case on the basis of the sham doctrine, namely that the Appellant intended, by virtue of the scheme documentation, to make things appear other than they were". The footnote to that submission states: "As set out by the UT in *Ingenious Games v HMRC* [2015] UKUT 0105 ("*Ingenious Games")* at paras 62 to 65, HMRC are entitled to plead a case on sham if, in the light of the evidence that emerges in cross-examination, relevant oral evidence which indicates sham emerges (as it did in the present case)."

44. The findings of the Upper Tribunal ('UT') in *Ingenious Games* referred to by HMRC are as follows:

> "IS IT NECESSARY FOR HMRC TO PLEAD DISHONESTY?
>
> [62] At the heart of the Appellants' amended case is the proposition that it is not open to HMRC to put allegations of dishonesty (or other serious forms of misconduct) to their witnesses, or to invite the FTT to make adverse findings of fact on such a basis, unless the relevant allegations have been pleaded with full particularity and the Appellants have been given a proper opportunity to respond to them.
>
> [63] In cases where the burden of proof lies on HMRC to establish fraud or dishonesty, these principles undoubtedly apply in the same way as they would in ordinary civil litigation. Examples include cases where HMRC wished to make assessments to income tax outside normal time limits on the ground (before 1989) of fraud or wilful default under s 36 of the Taxes Management Act 1970, or (in the modern world) where, relying on principles developed by the Court of Justice of the European Union, they wish to deny a VAT-registered trader his otherwise incontrovertible right to deduct input tax because of his alleged participation in, or connection with, 'missing trader' (or MTIC) fraud.
>
> [64] The present case, however, is not of that nature. It is common ground that the burden of proof lies on the Appellants to displace the closure notices issued to them by HMRC within normal time limits, and (in particular) to establish that the businesses of the relevant LLPs were carried on with a view to profit. This issue, as I have explained, is properly pleaded in HMRC's statement of case. No burden lies on HMRC to establish that the businesses were not carried on with a view to profit. It is for the Appellants to adduce such evidence as they think fit with a view to discharging the burden which throughout lies on them.

> [65] The IFP2 Information Memorandum is one of the pieces of documentary evidence relied upon by the Appellants as supporting their case on this issue. HMRC were under no obligation to accept it at face value, when it was disclosed to them, and they were fully entitled to cross-examine the witnesses for the Appellants who had been involved in its preparation in order to test its reliability and examine the assumptions on which it was based. HMRC were not obliged to give advance notice of the lines of questioning which they intended to pursue with the witnesses, and still less were they obliged to plead a positive case of dishonesty in preparation of the Memorandum before putting questions to the witnesses which, depending on how they were answered, might in due course provide a foundation for the FTT to draw such a conclusion. The obligations which lay on HMRC were in my judgment of a different nature. First, as a matter of professional duty, counsel may not put questions to a witness suggesting fraud or dishonesty unless they have clear instructions to do so, and have reasonably credible material to establish an arguable case of fraud. Secondly, as the FTT rightly recognised, it is not open to the tribunal to make a finding of dishonesty in relation to a witness unless (at least) the allegation has been put to him fairly and squarely in cross-examination, together with the evidence supporting the allegation, and the witness has been given a fair opportunity to respond to it. Important though these obligations are, they are quite different from, and do not entail, a prior requirement to plead the fraud or misconduct which is put to the witness. If it were otherwise, a party would be obliged to serve an amended statement of case before attempting to expose a witness as dishonest in cross-examination, and the element of surprise which can be a potent weapon in helping to expose the truth would no longer be available."

45. Ms Brown argues that HMRC misapplied the decision in *Ingenious Games* to the facts of this case and refers to HMRC's amended statement of case dated 29 June 2020 which stated that: "HMRC notes that Mr Northwood has adopted conflicting positions. Unless these are satisfactorily resolved HMRC will contend that the Remuneration Trust arrangements, or elements of the arrangements, were a sham". Ms Brown contends that is not, in fact, a pleading of sham but appears to be a warning that they may plead sham.

46. Ms Brown further contends that HMRC have not pleaded their case on sham properly because their skeleton argument is not a pleading, they did not refer to any of the documents referred to in their skeleton argument on sham in their statement of case, the argument was not trailed in their amended statement of case and HMRC's case on sham is not in light of Mr Northwood's evidence because they were clearly considering a sham argument before hearing that evidence.

47. Ms Brown accepts that the overall burden of proof is on Mr Northwood but contends there is a necessity to plead the sham in this case because HMRC would not be losing "a potent weapon in helping to expose the truth" as HMRC had already indicated that they might plead sham. Ms Brown further argues that the UT decision must be read in a more general context and in the context of paragraphs 66 and 67, which says:

> "[66] In the light of these distinctions, it becomes clear, to my mind, that the requests made by the Appellants at various stages of the trial for HMRC to state whether they were alleging fraud, and the Appellants' primary ground of appeal that the FTT 'erred in permitting unpleaded allegations to be made', are misconceived. The real questions, as it seems to me, are:
>
> (a) whether it is now too late for HMRC to put the relevant allegations to the three individuals; and

> (b) if it is not too late, whether it will in due course be open to the FTT to make findings of fraud or dishonesty in relation to the preparation and promulgation of the IFP2 Information Memorandum.
>
> [67] As to the second question, the FTT has said, and I see no reason to disagree, that on the evidence as it now stands they could not make any such findings. Apart from anything else, the allegations have not been put fairly and squarely to the witnesses, nor have they been given an opportunity to rebut them. It is therefore a legitimate criticism of HMRC's Evidence Paper that it invites the FTT to draw inferences, and reach conclusions, which are not at present open to them. But the evidence is not yet complete, and when the Evidence Paper was prepared both Mr Clayton and Mr McKenna were due to give further evidence at the resumed hearing. If HMRC are permitted to put the relevant allegations to them, the position may yet be reached where the FTT can properly make findings of fact on them."

48. Ms Brown submits that those are the relevant questions and highlights that HMRC was still in a position to put their allegations to the witnesses in *Ingenious Games*, which is different from this case. Ms Brown further argues that no amendment has been made to their statement of case, these are serious allegations and because HMRC have decided to plead a positive case, they are now putting forward a different position to the one in their statement of case and should not be permitted to rely on that which is inconsistent with what they have argued before.

49. I disagree with Ms Brown's submissions on this point. It seems to me, from the UT's remarks in *Ingenious Games*, that where the burden of proof lies on the appellant, as it does in this case, HMRC are not obliged to give advance notice of the lines of questioning or plead a positive case of dishonesty. I am not satisfied that there is any basis for the suggestion that that position is different where HMRC have now decided to plead a positive case. Further, the UT's comment regarding the element of surprise is simply, in my view, a reference to what would be the case if the position were different and does not change HMRC's obligations where the element of surprise is not an issue. It is my finding, in accordance with the UT decision in *Ingenious Games*, that HMRC have not breached their pleading obligations in respect of their arguments on sham.

50. The question of whether the allegations have been put fairly and squarely to Mr Northwood so that he has been given an opportunity to rebut them, is considered at [123] below.

BURDEN OF PROOF

51. The parties agree that Mr Northwood has the burden of proof in respect of his grounds of appeal, HMRC have the burden to prove their case on sham (but they do not have to do so for the appeal to be dismissed) and the standard of proof is the balance of probabilities. Accordingly, the appeal must fail unless Mr Northwood is able to persuade this Tribunal that the deductions claimed are valid. The appeal will also fail if HMRC prove their case on sham.

52. Ms Brown refers to the UT case of *Qolaminejite v HMRC* [2021] STC 1169 at [25]:

> "Because the burden is on the taxpayer it is entirely for the taxpayer to do the running on showing X is more likely than 'not X'. That is not to say that HMRC might not still have to 'exert' themselves… if HMRC fear the taxpayer's case was strong enough to get across the threshold of proof."

53. Ms Brown also refers to Lord Hoffmann's remarks in *Re B* [2009] AC 11 at [2]:

> "The law operates a binary system in which the only values are zero and one. The fact either happened or it did not. If the tribunal is left in doubt, the doubt is resolved by a rule that one party or the other carries the burden of proof. If the party who bears the burden of proof fails to discharge it, a value of zero is

returned and the fact is treated as not having happened. If he does discharge it, a value of one is returned and the fact is treated as having happened."

54. Ms Brown submits that:

(1) The Appellant has the burden of proving that the contributions were deductible because they were wholly and exclusively for the purposes of his profession;

(2) HMRC has advanced a case that the contributions were not made for the purposes that the taxpayer says they were made, and further that the documents entered into were a deliberate (and dishonest) concealment of the "true purpose";

(3) It is for HMRC to prove this, if they wish to, though of course they do not have to to win;

(4) In weighing up this decision the FTT should take into account the likelihood that if HMRC has tried to advance a positive case this is because they feel a need to (i.e. the evidentiary burden has passed to them); and

(5) Where HMRC make and fail to prove a positive case, the Appellant's appeal must be decided on the basis that HMRC's positive case is not what happened.

(6) The Appellant's submission is, therefore, that while HMRC do not have to prove anything, by choosing to advance a positive case of sham (based on dishonesty), they have taken on the burden of proving this positive case and should they fail to do so, this is likely to be a significant factor in favour of the Appellant having proved his case on the balance of probabilities.

55. Ms Brown accepts that there is no legal authority that supports this contention and invites the Tribunal to reach this conclusion on a common sense basis. I am not persuaded by this argument. A finding of sham requires the Tribunal to be satisfied of an intention to deceive or, at least, to make things appear other than as they are (see *The Brain Disorders Research Limited Partnership, Neil Hockin v HMRC* [2017] S.T.C. 1170 *('Hockin')* at [24]). I do not accept that a finding that HMRC have not proved their case on sham (and operating a binary system, that Mr Northwood did not intend to deceive or to make things appear other than as they are) can be considered to be a significant factor in favour of Mr Northwood proving his case that the contributions were deductible because they were wholly and exclusively for the purposes of his profession and in accordance with GAAP. I therefore do not accept Ms Brown's submissions on this issue.

THE EVIDENCE

56. In addition to the bundles of documentary evidence before the Tribunal (referred to at [2] above), I heard evidence from Mr Northwood and expert accountancy evidence from Mr Powrie, instructed on behalf of Mr Northwood, and from Mrs Reeves, instructed by HMRC.

57. In assessing the evidence, I have taken into consideration Ms Brown's submissions that:

(1) The matters in question occurred ten years or more ago and Mr Northwood does not have an entirely clear recollection, which is not surprising given the passage of time.

(2) The balance of probabilities does not, in any event, require that the whole of the matter fit together perfectly – to require it to do so, to have no inconsistencies or missing information - would be to impose a higher standard (see the Court of Appeal's decision in *Montracon v Whalley* [2005] EWCA Civ 1383 at [33]).

(3) Mr Northwood's evidence (his evidence-in-chief) is contained in his witness statement. This is, therefore, primarily what he relies on.

(4) HMRC used the time on cross-examination to read large chunks from documents and to make submissions, where the manner in which the information was elicited colours the answer in such a way that the questions asked by counsel (which are of course not the evidence) must be taken into account in considering what the evidence actually shows.

MR NORTHWOOD'S TESTIMONY

58. Mr Northwood's evidence is that he has no knowledge or expertise in tax, legal or financial matters. He has always worked as a self-employed trader and built a very successful business out of his dental practice. He had previously considered operating through a limited company but rejected this because of reduced operational flexibility and increased paperwork. Mr Northwood states that during the relevant period his leased business premises required commitment to a new lease in four years' time or to find different premises, but concerns were raised during discussions with Foy that owning business premises provided a potential vulnerability in the event that clients, employees or others made a legal claim against him. Foy introduced him to the concept of a "remuneration trust structure" as a way of achieving his aim of owning his practice premises while overcoming some of the concerns. Foy introduced him to BW as a "specialist legal company". He attended a meeting in August or September 2009 where Paul Baxendale-Walker talked about remuneration trust structures. He was told how such structures enable a mixture of all types of assets to be placed in a protected environment, had been used for many years unchallenged by HMRC who were fully aware of them, complied with all established tax law, were outside DOTAS (Disclosure of Tax Avoidance Schemes) procedures, could protect all classes of assets including cash, investment vehicles, commercial and domestic properties and could hold investments and property to be used as incentives to business contacts in a number of ways.

59. Mr Northwood states that, on the basis of the advice he had received, the meeting he attended and Paul Baxendale-Walker's book on remuneration trusts, he came to believe that a remuneration trust structure was a normal way of dealing with assets that many people had done before, without problem. He concluded that it was an effective way to grow his business, which gave protection to that business from third party claims, without the need to incorporate. He was, of course, aware, that the RT had tax benefits, but obtaining these was not his purpose in entering into the Trust. He also understood that they were tax benefits that were accepted by HMRC. He did not understand all of the ins and outs of the RT, but felt that he understood the business rationale. He states: "I can't recall 11 years down the line exactly my degree of understanding. I must have asked enough questions, I must have had enough information that I was happy that the answers there reflected the true situation. I rely on professional advisers. If my accountant or my independent financial adviser had looked at those answers and said, "These are not appropriate for your situation; they're incorrect," then I wouldn't have signed them. It's-- I-- this isn't-- any of this documentation isn't really something I have experience of on a day-to day basis, so I have to take professional advice on it."

60. Mr Northwood's evidence is that he believed the business had always been run in a way that placed commercial obligations on him towards his suppliers that were different to legal obligations. The commercial obligation was that, to obtain the most favourable trading terms and to maintain the best possible working relationships, he felt obliged to engage with them in the most professional manner. Bills are always paid early and in full and these obligations existed in his mind before, as well as after, the establishment of the RT.

61. With regard to his reasoning for setting up the RT, Mr Northwood says that discharging commercial obligations, as referred to in the BW Report, was not the sole reason that he started the RT. His use of funds within the RT led to enhanced payments to suppliers through increased business in a different way. The Report was a more standardised rather than a personalised

report, and he had a variety of reasons for starting the RT. Suppliers have benefitted from his enhanced practice and good commercial relationship. Mr Northwood states that the RT was partly to do with building up a pot of money that would let him invest in business premises and the trust would be used as a way to give incentives to suppliers.

62. In his witness statement, Mr Northwood says that it "was also explained that the structure had the ability to introduce my children into the trust investment process in the future. I have three children and I, therefore, want to protect their financial futures, too". In cross-examination he confirmed that "the talks had spoken about use of the trust structure for future planning regarding inheritance and children" but clarified that he was stating that the directive control of the trust would be potentially passed on to his children, not the contents of the trust fund.

63. When put to him in cross-examination, Mr Northwood disputed that the entire arrangements, basis for the resolutions and responses on the Questionnaire referring to substantial cash liabilities or substantial commercial liabilities to suppliers were just artificial and said that he was advised that this was a way that he could give long-term incentives to suppliers by making investments that would enhance his business. He refers to the amount spent with one supplier having gone up 30 per cent in the last three or four years, showing that they are benefitting from the business having nicer premises.

64. Mr Northwood states that the payments to the RT were not his funds anymore and were not drawings because they were an irrevocable contribution into a trust, where the funds were taken out of his control and unreservedly gifted. He makes the point that less than half of the funds paid into the Trust have been lent to him and investments made by MML have increased in value, benefitting the RT.

65. Mr Northwood's evidence is that he would have potentially not made the payments to the RT if they were known not to be tax deductible but, although he was aware of the potential tax advantage of the RT, this was not his purpose.

66. I do not consider the evidence given by Mr Northwood to be credible in respect of certain key issues.

FINDINGS OF FACT

67. Having considered the evidence before me, I make the following findings of fact.

68. I accept Mr Northwood's evidence that he was advised that he could enter into a set of arrangements which gave him the protection that he wanted for his business, in a way that offered him a tax advantage. I do not find Mr Northwood to have acted dishonestly in an attempt to evade tax or to conceal the overall arrangements.

69. However, with regard to his introduction to the arrangements, Mr Northwood refers to Foy as his "financial advisors", whereas the firm's email signature refers to "Trust Planning & Wealth Protection", and he claims that BW LLP were introduced to him as a "specialist legal company", but their letterhead refers to them as "The Wealth Strategy Firm". The slide deck sent to NatWest Bank ('NatWest') in July 2014 in order to secure a mortgage refers to the arrangements amounting to "tax free wealth with personal control" and refers to "unique features and benefits" which include: tax deduction against profits, no tax on contributions, tax free roll up of trust fund, loans allowed, no tax on loans, funds stay in UK and client manages own funds. I do not consider Mr Northwood's evidence regarding his introduction to the arrangements to be credible and it is my finding that Mr Northwood was made aware of the arrangements, at least partly, in the context of discussions about personal financial planning and not solely in the context of discussions about purchasing business premises, protecting business assets or incentivising suppliers. The NatWest slide deck also includes references to "Trust fund IHT free", "IHT deduction for loans at death" and "Client's will controls

succession" as "unique features and benefits" of the arrangements. Mr Northwood's evidence referred to the talks he had about use of the trust structure for future planning regarding inheritance and children, and that he wants to protect their financial futures. It is my finding that inheritance tax planning was one of the purposes of the RT payments.

70. With regard to Mr Northwood's evidence on his intention to benefit the beneficiaries of the RT (suppliers) by improving his business and its turnover, which would in turn benefit the suppliers by making direct gifts either of cash, or in the form of other incentives, based on how successful the business was over time, he accepts that nothing about the way he ran his business at the relevant time generated in his suppliers the expectation that they would receive substantial cash gifts and he accepts that it was never his intention that £570,000 would be distributed amongst his suppliers in the next financial year, as he considered it to be a long-term incentive trust. He accepts that it was never his intention, even in the long term, that all of that money would end up being paid out to suppliers because he had plans to develop his business and the suppliers would benefit in the long term from the business having nice premises and a much increased turnover. Mr Northwood accepts that the size of cash gifts made to suppliers in the last ten years has been the odd case of wine and one cash gift of £250 and that the suppliers listed on the Providers List were not aware of the existence of the RT. I do not find Mr Northwood's evidence of his intention to benefit suppliers to be credible. It is my finding that no commercial obligations to suppliers existed and I therefore find that incentivising or discharging commercial obligations to suppliers was not a purpose of the RT payments.

71. Ms McCarthy challenged Mr Northwood's evidence that he concluded the RT was an effective way to grow his business, which gave protection to that business from third party claims without the need to incorporate. When asked how the RT protected his privately owned assets from a legal claim, Mr Northwood said that the practice is owned by MML and that offers security. When it was put to him that the tax benefits of operating the business through a straightforward limited company were dwarfed by declaring tax of £10,000 or less for the years since using the trust, he simply said that he chose not to practice as a limited company in the years prior to being introduced to a remuneration trust as a possibility. I do not consider it to be credible that Mr Northwood previously rejected the option of operating through a limited company because of reduced operational flexibility and increased paperwork but concluded, despite any reduced operational flexibility and increased paperwork involved with the RT, that the RT was an effective way to grow his business, which gave protection to that business from third party claims without the need to incorporate. I find that operating and growing the business in an effective and protected way, without incorporation, was a factor considered by Mr Northwood when entering the arrangements but was not a purpose of the RT arrangements.

72. I do not accept Mr Northwood's evidence that he no longer had control of the RT funds. In an email to Foy in February 2010 Mr Northwood stated: "I'd be grateful if you could let me know how I proceed for payments in/out from now on. I've arranged for the practice drawings for January to be paid into the Marhel Management account direct." I do not accept as credible Mr Northwood's explanation that he meant "cash" instead of "drawings". In his correspondence with NatWest Bank in July 2014, Mr Northwood refers to his income as including "Other monies available from RT" and states: "For the last 3 year, I have paid the greatest part of the business profits into a remuneration trust whose funds myself and my wife have control of through a fiduciary, Marhel Management Ltd. These payments are visible in the business and personal accounts." It is my finding, on the basis of the evidence before me, that Mr Northwood retained personal control of the funds paid to the RT, after the payment of fees.

73. With regard to the loans made to Mr Northwood, I find that the terms were not commercial or made at arm's length, every loan requested was granted, Mr Northwood authorised MML to make the loans and Mr Northwood signed the loan documentation both in his capacity as borrower and on behalf of MML as lender. I do not find that the loans made to Mr Northwood from the RT to have been genuine loans.

74. Mr Northwood's evidence is that the potential tax advantage of the RT was not his purpose and that he sought the view of an independent third party to confirm that the arrangements did not amount to tax avoidance. Ms Brown submits that Mr Northwood understood that the payments he intended to make to purchase the business premises would have the same effect whether made by him directly or through the RT, and asks the Tribunal to draw an inference of fact that, far from being a purpose, the potential tax effects of the arrangements were a cause for concern for Mr Northwood, and an effect that caused him to consider not executing his purpose (to expand and improve his business through the purchase of new premises) through the arrangements at all. NatWest's view of the arrangements, as set out in an email on 16 July 2014, was "Basically this tax avoidance is structured so that the individual is probably taking all of the profit (you will be able to see from the accounts) from his dentist business tax free rather than paying income tax at 40%-50%... we must not fund tax avoidance such as this which seeks to artificially reduce income tax liabilities to nil or virtually nil". Ms Brown submits that NatWest ultimately gave the loan to MML and not Mr Northwood. In his evidence, Mr Northwood said "It doesn't appear that I was as truthful…" with regard to his NatWest interactions. Having considered the totality of evidence in this case, I am not persuaded by Ms Brown's submissions on this point and I do not consider Mr Northwood's evidence, that the potential tax advantage was not his purpose, to be credible. It is my finding that the payments to the RT were made with the purpose of obtaining tax advantages.

75. On the basis of my findings regarding the purpose of the payments, I do not consider the documentation regarding the RT to accurately reflect the arrangements.

76. Resolution A states that it "is resolved that the Business make contributions to a scheme established under irrevocable trust ("the Scheme") for the purpose of funding the provision of discretionary benefits to providers of service, services, products and custom to the Business and their respective wives, widows and dependants". Mr Northwood accepts that discharging commercial obligations to suppliers was not the sole reason for the arrangements and, having found that the payments to the RT were made with the purpose of obtaining tax advantages, I do not consider this to be an accurate reflection of the purpose of the contributions.

77. The Questionnaire states that the trade has "been conducted in such a way as to place a commercial obligation on the business to provide benefits for consultants and other suppliers" and that the "discretionary trust allows each potential beneficiary to make a case to the trustees for the receipt of a benefit and for the Trustees to determine what benefits should be paid out". Having found that discharging commercial obligations to suppliers was not a purpose of the contributions and the suppliers were unaware of the Trust, I do not consider this to be an accurate reflection of the position regarding commercial obligations or the basis upon which a potential beneficiary could make a case to the trustees for the receipt of a benefit.

78. Resolution B "resolved that the proposed amount of contribution to the Scheme for the fiscal year ending on 31st March 2010 reflects part of the economic cost to the Business of earning its profits for that period and constitutes the discharge of its constructive obligation". Again, I do not consider this to be an accurate reflection of the position regarding commercial obligations.

79. I also do not consider the Trust Deed and Deed of Amendment (supplemental to the Trust Deed) to accurately reflect the position regarding the stated beneficiaries. I also find that the Delegated Manager and Custodian Agreement and the Fiduciary Services Agreement do not accurately reflect that the RT funds remained in Mr Northwood's control.

80. It is my finding that the documentation relating to the RT was intended to make things appear other than they were, for the purpose of obtaining tax advantages.

EXPERT EVIDENCE

81. Ms Brown invites the Tribunal to find that Mrs Reeves, while honest, was unconsciously unable to maintain her independence due to the fact that she is employed for the last 14 years by HMRC and as such all her training, professional development and experience has been gained in the context of HMRC's control (and considering her professional opinion has accorded with HMRC's view of the accounting treatment). I am not persuaded by Ms Brown's submission. I do not consider Mrs Reeves' HMRC employment alone to be a sufficient basis to challenge her professional integrity and independence. I consider Mrs Reeves to have given credible evidence of her mindful independence, saying that: "I consider whether I am able to give an honest and free from bias opinion, and I believe that I am. I'm under no pressure to give any particular opinion." It is my finding that Mrs Reeves understood her duty to the Tribunal and gave her opinion uninfluenced by partisan considerations (see *Anglian Water Services Ltd v HMRC* [2017] UKFTT 386 (TC) at [83]).

82. Further, I do not accept Ms Brown's submission that Mrs Reeves' report should carry little or no weight since Mrs Reeves was unable to explain several errors such as her confusion over the entity in question (i.e. whether a "partnership" known as The Brace Place existed or not) and her failure to include relevant accounting standards FRS 18 and UITF Abstract 13. I do not consider the report demonstrates a confusion over the entity in question. Mrs Reeves' evidence is that she is describing what she sees in the accounts, namely that the net profit has been divided between the two individuals. I also accept Mrs Reeves' evidence that she "did look at UITF 13 and didn't consider that it added anything to what is already set out in UITF 32" and that a footnote to her report, which refers to the objective to show a true and fair view of the business (where accounts are being prepared in accordance with GAAP), accords with FRS 18.

83. I also do not accept Ms Brown's submission that Mrs Reeves did not understand UITF Abstract 32, in particular "de facto control" and how to apply the test of the rebuttable presumption in relation to control and payments being made in accordance with a sponsoring entity's wishes. I accept Ms Belgrano's submission that both experts agreed that Mr Northwood had control in an accounting sense of the RT assets and I do not consider Mrs Reeves' report to be fundamentally flawed in respect of her understanding of de facto control.

84. HMRC submits that the Tribunal should give Mr Powrie's report and evidence no weight because Mr Powrie did not give objective, unbiased opinions and his assumption of the role of an advocate permeated his written and oral evidence.

85. Although it is not in dispute that Mr Powrie qualified in 1982 as a fellow of the Institute of Chartered Accountants, on the basis of his evidence, I accept HMRC's submission that Mr Powrie's practice is as a tax specialist, not as an accountant, and Mr Powrie's report states that at the time when the matters on which he is reporting on took place, his practice involved him on advising on matters relating to planning with Employee Benefit Trusts.

86. HMRC contends that Mr Powrie failed to utilise any standards or reference material to support his central conclusions. On this point, Mr Powrie's report stated that:

> "In producing this report I have relied on the following:

> 1.2.1 All relevant parts of the taxation code for the United Kingdom including, but without restriction to, s.25 ITTOIA 2005, s.997 ITA 2007, s.1127 CTA 2010 and to all relevant elements of the rules and principles applying to the preparation of accounts including, but without restriction to, The Statement of Principles for Financial Reporting and the Financial Reporting Standard 5."

87. I accept HMRC's submission that there were no specific references to standards or materials in the report's conclusion.

88. HMRC argues that a significant proportion of Mr Powrie's analysis is geared towards making legal arguments and the core of his analysis is focused on arguing against HMRC contentions, rather than setting out his own, free-standing analysis. Mr Powrie's evidence regarding his approach to HMRC's statement of case was that: "if I hadn't argued with it, then presumably it would have to be accepted by the Tribunal. It was crucial that the mistakes, the misunderstandings that in my opinion were in the statement of case were corrected."

89. HMRC also refers to examples of incomplete commentary designed to advance Mr Northwood's position, for example by offering only supportive commentary on "soft loans" and interest rates (outside the scope of his expertise) without making mention to other features of the lending, such as no security, no credit checks, 10-year term, rolling up interest and principal repayable only at the end of the term.

90. I agree with HMRC that an expert should provide a balanced analysis and not simply present matters which provide support for their conclusion. Mr Powrie did not refer to the lack of security or credit checks in his analysis of the loans, although he did mention that he understands "that it may be that the trustees will then roll these loans over or, in other ways, provide compensation if Mr Northwood has to repay the loans" before he concluded that "it does not seem to me to be right to say that monies which have, through a variety of processes, ended up as loans to the proprietor of a business on interest bearing terms and subject to repayment can be drawings".

91. In general terms, as HMRC submits, Mr Powrie's analysis focused on arguing against HMRC contentions. Mr Powrie states in his report that he understands that he should not assume the role of an advocate. However, he refers to "various statements of accounting practice which may be relevant to our structure" and then states that the "question then arises as to how the purported contributions should be treated for accounting purposes within that framework. It appears to me that there are four separate contentions made by HMRC as to how they should be treated and each of them raise different issues", before setting out his opinion, rejecting HMRC's contentions. Such an approach does give support to HMRC's argument that Mr Powrie assumed the role of an advocate. However, I have also considered that, whilst Mr Powrie's conclusions rely upon the acceptance of Mr Northwood's evidence, he also makes references to alternative findings of fact or law being matters for determination by the Tribunal that would lead him to different conclusions. I therefore do not consider Mr Powrie's actions go as far as amounting to neglect of his duties as an independent expert. I do, however, consider the approach taken by Mr Powrie to affect the weight I give to his evidence and I have no hesitation in preferring Mrs Reeves' balanced analysis and report, supported by detailed references to accountancy standards and materials.

GAAP

92. It is accepted by the parties that the profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes (under section 25(1) ITTOIA 2005). It is also accepted that Mr Northwood's accounts should therefore have been prepared in accordance with UK GAAP.

93. I consider the relevant accounting principles to be those set out by Mrs Reeves in her report, as follows:

> "Financial Reporting Standard 5 'Reporting the Substance of Transactions' (FRS5)
>
> 4.4. FRS5 has the stated objective to "ensure that the substance of an entity's transactions is reported in its financial statements. The commercial effect of the entity's transactions, and any resulting assets, liabilities, gains or losses, should be faithfully represented in its financial statements" (FRS5.1).
>
> 4.5. FRS5 contains the following requirements:
>
> "A reporting entity's financial statements should report the substance of the transactions into which it has entered. In determining the substance of the transaction, all its aspects and implications should be identified and greater weight given to those more likely to have a commercial effect in practice. A group or series of transactions that achieves or is designed to achieve an overall commercial effect should be viewed as a whole." (FRS5.14)
>
> "To determine the substance of a transaction it is necessary to identify whether the transaction has given rise to new assets or liabilities for the reporting entity and whether it has changed the entity's existing assets or liabilities." (FRS5.16)
>
> "Evidence that an entity has an obligation to transfer benefits (and hence has a liability) is given if there is some circumstance in which the entity is unable to avoid, legally or commercially, an outflow of benefits." (FRS5.18)
>
> "Where a transaction results in an item that meets the definition of an asset or liability, that item should be recognised in the balance sheet if-
>
> (a) There is sufficient evidence of the existence of the item (including, where appropriate, evidence that a future inflow or outflow of benefit will occur), and (b) The item can be measured at a monetary amount with sufficient reliability." (FRS5.20)
>
> "Where a transaction involving a previously recognised asset transfers to others-
>
> (a) All significant rights or other access to benefits relating to that asset, and
>
> (b) All significant exposure to the risks inherent in those benefits, the entire asset should cease to be recognised." (FRS5.22)
>
> "Paragraph 14 of the FRS sets out general principles for reporting the substance of a transaction. Particularly for more complex transactions, it will not be sufficient merely to record the transaction's legal form, as to do so may not adequately express the commercial effect of the arrangements. Notwithstanding this caveat, the FRS is not intended to affect the legal characterisation of a transaction, or to change the situation at law achieved by the parties to it." (FRS5.46)
>
> "Whatever the substance of a transaction, it will normally have commercial logic for each of the parties to it. If a transaction appears to lack such logic from the point of view of one or more parties, this may indicate that not all related parts of the transaction have been identified or that the commercial effect of some element of the transaction has been incorrectly assessed." (FRS5.51)
>
> 4.6. FRS5 contains the following definitions:

Assets: "Rights or other access to future economic benefits controlled by an entity as a result of past transactions or events." (FRS5.2)

Control in the context of an asset: "The ability to obtain the future economic benefits relating to an asset and to restrict the access of others to those benefits." (FRS5.3)

Liabilities: "An entity's obligations to transfer economic benefits as a result of past transactions or events." (FRS5.4)

Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets' (FRS12)

4.7. FRS12 sets out the principles of accounting for specific types of liability: provisions and contingent liabilities. It therefore contains some useful definitions concerning the concept of liabilities (FRS2.2):

Liabilities: "Obligations of an entity to transfer economic benefits as a result of past transactions or events." This is consistent with the FRS5 definition above.

Obligating event: "An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation."

Legal obligation: "An obligation that derives from:

(a) A contract (through its explicit or implicit terms);

(b) Legislation; or

(c) Other operation of law."

Constructive obligation: "An obligation that derives from an entity's actions where:

(a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities."

4.8. Further guidance is given on the concepts of past events and constructive obligations. Whilst the specific context of the guidance is in respect of provisions (being a liability of uncertain timing or amount), the principles apply equally to the wider the context of liabilities more generally:

"Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's balance sheet are those that exist at the balance sheet date." (FRS12.18)

"It is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognised as provisions." (FRS12.19)

"An obligation always involves another party to whom the obligation is owed. […] Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the balance sheet date unless the decision has been communicated before the balance sheet date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities." (FRS12.20)

Statement of Principles for Financial Reporting (SoP)

4.9. Whilst not an accounting standard, the SoP sets out various fundamental principles which the Accounting Standards Board considered should underpin the financial statements of profit-oriented entities.

4.10. The concepts of assets and liabilities described in the SoP are consistent with those set out in FRS5 and FRS12, as described above.

4.11. Definitions are given in the SoP for 'gains' (incorporating all forms of income and revenue) and 'losses' (incorporating all forms of expenses), which are referred to in the objective of FRS5 (see paragraph 4.4 above):

"Gains are increases in ownership interest not resulting from contributions from owners" (SoP4.39)

"Losses are decreases in ownership interest not resulting from distributions to owners." (SoP4.39)

"Ownership interest is the residual amount found by deducting all of the entity's liabilities from all of the entity's assets." (SoP4.37)

"Distributions to owners are decreases in ownership interest resulting from transfers to owners in their capacity as owners." (SoP4.42)

4.12. It follows that losses would be included in the profit and loss account, as expenses, whereas distributions to owners in their capacity as owners would not (because they are not losses). In the context of sole traders, drawings are equivalent to distributions because they represent the use of assets in a personal rather than business capacity. Urgent Issues Task Force Abstract 32 'Employee benefit trusts and other intermediate payment arrangements (UITF32)

4.13. UITF32 considers the application of general accounting principles, in particular those in FRS5 as set out above, to the specific situation of intermediate payment arrangements. Whilst typically such arrangements involve the use of trusts for the payment of an entity's employees, the scope of UITF32 includes other arrangements, for example those which are used to compensate suppliers of goods and services (UITF32.3(b)).

4.14. Two questions are considered in UITF32:

(i) Does the sponsoring entity's payment to the intermediary represent an immediate expense?

"A payment made to an intermediary will represent an immediate expense of the sponsoring entity only if the payment neither results in the acquisition of another asset (for example, restricted cash or a prepayment) nor settles a liability. Whether a payment involves the full or partial settlement of a liability is a matter of fact and is not considered in this Abstract. The Abstract focuses instead on whether the payment involves the acquisition of another asset." (UITF32.7)

"An asset is defined in the Statement of Principles for Financial Reporting as a right or other access to future economic benefits that is controlled by the entity as a result of a past transaction or event. The attributes of an asset are therefore access to future economic benefits and the control of that access.

(a) Future economic benefit can be obtained in a variety of forms. In the context of intermediate payment arrangements, probably the most common form the benefit takes is meeting some or all of the cost of goods or services provided to the sponsoring entity. That benefit can be the basis for an asset

> even though it is not capable of being turned into cash or of being distributed in a liquidation.
>
> (b) Control comprises two abilities, the ability to direct and the ability to benefit from that direction. Although control is probably most visible when it is exerted through intervention and instruction on an ongoing day-to-day basis, it can be present in a variety of other guises. For example, even though a sponsoring entity of an intermediate payment arrangement involving a trust does not have the right to dictate to trustees how they should exercise their responsibilities under a trust, it may still […] have de facto control of that trust's assets and liabilities […]". (UITF 32.8)
>
> "FRS 5 requires that, when determining whether an entity has an asset, one should look beyond the structure of the transaction to consider its substance; in other words, consideration should be given to the commercial effect of the transaction in practice. Recognising that it is highly unusual for an entity to pay a significant amount to a third party without receiving something in return, the UITF takes the view that, when an entity transfers funds to an intermediary, there should be a rebuttable presumption that the sponsoring entity will obtain future economic benefit from the amounts transferred and that it has control of the rights or other access to those future economic benefits." (UITF 32.9)
>
> "To rebut this presumption at the time the payment is made to the intermediary, it will be necessary to demonstrate that either:
>
> (a) The sponsoring entity will not obtain future economic benefit from the amounts transferred. For example, it may be that the only beneficiaries of the intermediary are registered charities or a benevolent fund that is in no way linked to amounts otherwise due from the entity; or
>
> (b) The sponsoring entity does not have control of the rights or other access to the future economic benefits it is expected to receive. This will involve evidence that the payments made by the intermediary are not habitually made in a way that is in accordance with the sponsoring entity's wishes." (UITF 32.10)"

94. It is common ground between the parties that Mr Northwood would not be entitled to claim an income tax deduction for drawings.

95. Ms Brown contends that Mr Northwood's accounts have been prepared in accordance with UK GAAP because:

> "8.12.1 The contributions are accounted for in the year in which they were made;
>
> 8.12.2. In accordance with FRS5, the profits of the Appellant's profession have been calculated in such a way that they represent the substance of the transactions entered into, particularly in relation to the contributions. This is because the contributions removed the money from the Appellant's personal control so – while he remained in a position to direct the investment and management of the assets subject to his contributions – he did so in a fiduciary capacity and could not benefit from it himself. He could not, in fact, use those funds in any way that was not for the benefit of the beneficiaries of the trust (i.e. all significant rights or other access to benefits relating to the assets contributed were transferred to others – FRS5, paragraph 5.22);
>
> 8.12.3. Upon transfer to the trust, the assets were no longer available to the business or claimants of the business and as such in accordance with UK GAAP are properly deductible;

8.12.4. the Appellant did not obtain or retain future economic benefit from the assets transferred to the trust and because his only involvement with them thereafter was by reference to interest-bearing loans, or in their management in his capacity as director of a fiduciary appointed to manage the assets, he did not retain, or have access to the future economic benefit from the assets transferred (UITF32); and

8.12.5. While the Appellant could "draw" (used in a non-technical, non-accounting sense) on the assets in the trust he could only do so if an interest-bearing loan was granted and as such he did not have access to the trusts assets, rather on occasion the trust provided funding to him on terms that altered the nature of the assets in the trust from cash to be a chose in action to recover amounts owed. As such, he could not obtain future economic benefit."

96. The expert accountancy report prepared by Mr Powrie of behalf of Mr Northwood is based on certain legal and factual assumptions. The conclusion in his report states:

"CONCLUSION

9.1 In conclusion, where funds have been paid away to RTs during the course of an accounting period, it is my conclusion that these amounts should be shown as a deduction in arriving at the profits under GAAP. However, were it to be found as a matter of law that the documents gave rise to the application of the sham transaction doctrine then my conclusion would be that, depending on how that doctrine would cause the transactions to be re-analysed, it might well be that it had the effect that the amounts should not be shown as a deduction in arriving at the profits under GAAP.

9.2 In particular, I have considered whether the contributions to the RT should be recognised as an expense in the profit and loss account of Mr. Mark Northwood and have reached the conclusion that, absent the sham transaction doctrine, they should because they represent funds paid away by that entity to the RT and are no longer available to the entity.

I have specifically considered whether the fact that funds were lent by the Trustees to Mr. Mark Northwood to make contributions means that those contributions were, either not an expense of Mr. Mark Northwood or, if they were, were not "incurred" by Mr. Mark Northwood. My opinion is very clear; I can see nothing in the way in which Mr. Mark Northwood obtained part of the monies contributed to the RT which could make any difference to the question as to whether they were an expense or whether that expense was incurred by Mr. Mark Northwood. It is common commercial practice for businesses to borrow money from, most commonly but not solely, banks to deal with expenses of their trade and I have never seen an argument that that means that those expenses are not incurred by the business nor do I consider in my opinion that any such argument could stand up. However, I would accept that if there was evidence that these loans were never to be repaid and were, effectively, gifts from the trust to Mr. Mark Northwood, with the purpose of them being recontributed back to the trust, then further payments by Mr. Mark Northwood would not constitute an expense incurred by Mr. Mark Northwood's business.

9.3 The question as to whether the expenses so incurred were wholly and exclusively for the purposes of the trade depends on the motivation of Mr. Mark Northwood in making those payments. I have not had the opportunity to speak to Mr. Mark Northwood about his motivation and my conclusion is that it is a matter for the Tribunal, based on the evidence put before it, to determine his motivation. If that motivation was to benefit his trade then the

expenses would satisfy the wholly and exclusively test; if they were for some non-business reason, then they would not.

9.4 In respect of the fees paid by Mr. Mark Northwood, they would follow, in my considered opinion, the question as to the deductibility under the wholly and exclusively rule. If Mr. Mark Northwood took advice with a view to developing a strategy which would benefit his business, then the expenses incurred in taking that advice would clearly be, in my opinion, allowable.

9.5 In considering whether transactions should be recorded within the Appellants business accounts, I cannot accept, as such, the way in which that has been put to me which is that private items cannot be referred to in business accounts; it is my practical experience that personal expenditure of proprietors of sole trades can be included in business accounts but it is normally the case that they will not meet the wholly and exclusively test and so their mere entry in those accounts does not mean that they will be deductible in arriving at profits for tax purposes. I have, however, said that the pre-existence of a liability does not, in my opinion, affect the question as to whether or not an item is deductible. Purely by way of example, a business may choose to make a voluntary payment to a retiring employee with the good commercial purpose that that will incentivise other employees to stay with the business. There is no pre-existing liability; however, there is a benefit of a commercial nature and so there is deductibility.

9.6 I have explained in para 5.1 that I do not believe that the question of constructive obligation is relevant to this case. It might be helpful to explain what a constructive obligation is and the difference between that and a commercial obligation. To give a simple example, if I order goods from a supplier, agree terms and they are then delivered, I will have a commercial obligation to meet his invoice. A constructive obligation is one that arises out of a course of conduct. However, this is not relevant because, in my understanding, that question arises only where contributions are not made during the course of an accounting period. If they are to be included in the accounts for a year, in my understanding there must either be an actual payment during the year or it must be established that there was a constructive obligation to make such a payment. For example, if an employer tells his staff during the course of the year that he intends to pay them a bonus of 10% of the profits but that he cannot calculate that number until the annual accounts are prepared which will determine the quantum of profits, then that is, in my understanding, an example of a constructive obligation and such a bonus could be read back into the accounts for the year to which the bonus relates. However, if no arrangements are discussed at all in the course of an accounting period and subsequently the company or employer decides that a bonus by reference to those profits would be a good idea, that cannot be read back into the accounts for the period to which it relates. I would accept that, absent any evidence to the contrary, constructive obligation did not exist in this case but that is not relevant because Mr. Mark Northwood actually paid the contributions during the year.

9.7 I simply do not understand the argument that funds borrowed from the trust and then contributed to the trust as described in para 3.9 above are in some way excluded from the normal rules that say that monies laid out for the purposes of the business cannot be wholly and exclusively for the purposes of that business. If Mr. Mark Northwood gradually increased his indebtedness to the trust, that would be a real obligation."

97. Mr Powrie's opinion is that a constructive obligation to pay suppliers did not exist in this case but that is not relevant because Mr Northwood actually paid the contributions during the

year. His statement that it is not necessary to consider whether there is a liability where a payment is made during the accounting period does not address the accruals basis principle of accounting or the point made by UITF 32.5, that "Generally speaking, most expenses are incurred not when they are paid for but when a liability arises…". I agree with HMRC's submission that it is necessary to consider whether the business had a liability in order to determine whether (and if so, when) it was appropriate to recognise an expense because if there is no liability, then there would be no expense to recognise.

98. On the basis of my legal and factual findings, I do not accept Ms Brown's submission that Mr Northwood's accounts have been prepared in accordance with GAAP. I do not agree that the profits of his profession have been calculated in such a way that they represent the substance of the transactions entered into. I have found that the contributions did not remove the money from Mr Northwood's personal control and upon transfer to the trust, he did retain future economic benefit from the assets transferred.

99. I therefore agree with HMRC that the accounts were not prepared in accordance with GAAP and I accept the evidence given by Mrs Reeves that the correct accounting treatment under GAAP is as follows:

> "a. The RT arrangement falls within the scope of UITF 32, because it is represented as an intermediate payment arrangement between the Appellant (as sponsoring entity) and his suppliers and/or their relatives (as beneficiaries).
>
> b. The Appellant can access future economic benefit for his business from the contributions made to the RT and it has not been demonstrated that his business will not obtain future economic benefit.
>
> c. The Appellant has control of that future economic benefit.
>
> d. Therefore the presumption in UITF 32 that the Appellant's business could obtain future economic benefit from the amounts contributed to the RT, and that the Appellant was able to control access to those benefits, has not been rebutted.
>
> e. It was not in accordance with GAAP to account for the contributions as an immediate expense, and the Appellant's expenses are overstated by the following amounts:
>
> Year to 31 March 2010 £570,000
>
> Year to 31 March 2011 £498,787
>
> Year to 31 March 2012 £500,000
>
> Year to 31 March 2013 £555,000
>
> f. The Appellant should have initially recognised assets in respect of the contributions held by the RT, in the amounts set out above.
>
> g. Thereafter he should have accounted for the RT as an extension of his own business, recognising assets, liabilities, income, expenditure, capital contributions and drawings in accordance with the substance of the underlying transactions."

100. Accordingly, I find that the payments made to the RT do not give rise to an expense under GAAP and therefore do not give rise to an income tax deduction, in accordance with section 25(1) ITTOIA 2005.

INCURRED

101. The Tribunal was asked to consider, if the payments to the RT were found to be an expense under GAAP, whether the expense had been "incurred" for the purposes of section 34 ITTOIA 2005.

102. HMRC submits that where only £150,000 was contributed by Mr Norwood to the RT and he claimed an income tax deduction in relation to a supposed contribution of £450,000, by using a leverage mechanism whereby £150,000 went round in a circle three times between Mr Northwood and BW, Mr Northwood did not bear the economic burden of the alleged contribution because, quite simply, he did not have the cash to make the contribution.

103. HMRC refers to the decision in *Ingenious Games LLP; Inside Track Productions LLP; Ingenious Film Partners 2 LLP* [2019] STC 1851, where the UT expressed the view (obiter) that an expense will only be "incurred" where the taxpayer bears the "economic burden" of an expense. HMRC invites the Tribunal to apply the same approach in the context of this case.

104. Having considered the judgment of the Supreme Court in *Revenue and Customs Commissioners v NCL Investments Ltd* [2022] UKSC 9, with regard to section 54 of the Corporation Tax Act 2009 (which is analogous to section 34 ITTOIA 2005 and provides, for corporation tax purposes, that no deduction is allowed for expenses not incurred wholly and exclusively for the purposes of the trade), I reject the approach suggested by HMRC. The point is addressed by the Supreme Court, as follows:

> "36. As to whether the Debits were expenses "incurred", Mr Ghosh points out that neither section 48, nor any other provision in CTA 2009, deems the Debits to have been "incurred" by the Companies. He submits that given that the Companies suffered no cost in relation to the Debits, the Debits cannot be said to have been "incurred" by the Companies.
>
> 37. In this connection, Mr Ghosh again seeks to rely on *Lowry* and the majority's approach in that case to what was required for expenses to be "laid out or expended", the predecessor wording to "incurred" in section 54(1)(a). Reliance is also placed on an obiter passage in the Upper Tribunal's decision in in *Ingenious Games LLP v Revenue and Customs Comrs* [2019] STC 1851, in which it was stated that the term "incurred" in section 54(1)(a) CTA 2009 is "concerned with whether the taxpayer bore the economic burden of an expense" (para 434) and that that approach "makes sense given the context of the statutory test, namely the determination of profit" (para 457).
>
> 38. We reject HMRC's case that section 54 imports a further requirement as to what constitutes an "expense", namely that it has to be shown to be "incurred". The requirements for what constitutes an expense are as set out in sections 46 and 48. These are part of Chapter 3 which is headed "Trade Profits: basic rules". Those basic rules require that it is brought into account as a debit in accordance with generally accepted accounting principles (section 46). If so, it will be an expense for the purpose of the calculation of trading profits, whether or not an amount has actually been paid (section 48(1) and (2))."

105. In Mr Northwood's case, the basic rules also require profits of the trade to be calculated in accordance with generally accepted accounting practice (under section 25(1) ITTOIA 2005). I do not consider there to be a further requirement for Mr Northwood's contribution to be shown to be "incurred" and I do not accept, as HMRC suggest, that I should adopt a different approach because the Supreme Court decision was in the context of a case that did not concern tax avoidance.

WHOLLY AND EXCLUSIVELY

106. Ms McCarthy refers to the FTT decision in *Strategic Branding Limited v HMRC* [2021] UKFTT 0474 (TC) ('*Strategic*') where it was held that a corporation tax deduction was not available in circumstances concerning similar arrangements, and to the Court of Appeal decision in *Vodafone Cellular Ltd and ors v Shaw* [1997] STC 734, where Millett LJ said at page 742:

> "The leading modern cases on the application of the exclusively test are *Mallalieu v Drummond (Inspector of Taxes)* [1983] STC 665, [1983] 2 AC 861 and *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co* [1989] STC 898, [1990] 2 AC 239. From these cases the following propositions may be derived. (1) The words for the purposes of the trade mean to serve the purposes of the trade. They do not mean for the purposes of the taxpayer but for the purposes of the trade, which is a different concept. A fortiori they do not mean for the benefit of the taxpayer. (2) To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment. (3) The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment. (4) Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made. To these propositions I would add one more. The question does not involve an inquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary inquiry is to ascertain what was the particular object of the taxpayer in making the payment. Once that is ascertained, its characterisation as a trade or private purpose is in my opinion a matter for the commissioners, not for the taxpayer."

107. Ms McCarthy submits that similar arrangements have been recently considered by the General Anti-Abuse Rule ('GAAR') Advisory Panel. The GAAR Advisory Panel is an independent advisory panel which approves HMRC's GAAR guidance, and provides opinions on cases where HMRC considers the GAAR may apply. On 7 April 2020, the Panel released two Opinions on very similar arrangements, observing that they considered "the arrangements as a whole to be contrived and abnormal and appear… to serve no useful purpose other than to avoid tax". Ms McCarthy contends that the same approach should be taken in this case since nothing in Mr Northwood's evidence is capable of supporting a different conclusion.

108. Ms Brown argues that payments were for business purposes because the context of the ultimate decision to enter in to the arrangements was to enable Mr Northwood to grow and develop his business with new, better business premises, which meant that he would be able to increase his business, and thus give more business to his suppliers. There was no dual purpose. Mr Northwood was under the impression that there was no immediate tax advantage in his circumstances (as he would have been able to deduct the payments for premises) and was concerned as to whether or not these were arrangements that would constitute tax avoidance. Consequently, it can be seen that his purpose was one wholly and exclusively for the purposes of earning the profits of his trade, and that the tax consequences of the way in which he chose to do this were an effect, but was neither a purpose nor an effect so inextricably linked to the method of entering into the transaction that it should be treated as an unconscious purpose.

109. I have considered Judge Zaman's comments in *Strategic* as follows:

> "155. In *Scotts Atlantic*, in obiter consideration of the question of wholly and exclusively and whether there was duality of purpose (but based on authorities which are binding on this Tribunal), the Upper Tribunal reiterated that:
>
> (1) The word "exclusively" means that if the expense was also incurred for some other purpose, it is not deductible (at [47]).
>
> (2) Citing Millett LJ in *Vodafone* at [742] (and as set out more fully above), the object of the expenditure must be distinguished from its effect. If the sole object of the expenditure was the promotion of the business, the expenditure is deductible, even though it necessarily involves other consequences. Thus, the existence of a private advantage does not necessarily mean that the expenditure is disallowable. A merely incidental effect of expenditure is not necessarily an object of a taxpayer in making it. What the FTT must not do is to conclude that merely because there was an effect, that effect was an object (at [51] and [52])
>
> (3) In addition, at [53], some results are so inevitably and inextricably involved in particular activities they cannot but be said to be a purpose of the activity and as a result the conscious motive of the taxpayer is not decisive.
>
> (4) Neither the statutory provision nor any of the cases indicate that the way in which an expense is incurred will determine whether the expense is deductible. The question is what is the object of the expense, not what was the object of the means of incurring it. A trader may have a choice of the way in which it achieves an end which is exclusively for the benefit of the trade. The mere fact that a choice is influenced or dictated by the tax consequences does not necessarily mean that the choice involves a duality of purpose as regards the expense (at [54] and [55]).
>
> (5) Expenditure is not disqualified because the nature of the activity necessarily involved some other result, in other words that the mere existence or knowledge of that result is not enough to give a dual purpose. But if the fact-finding tribunal concludes that its inquiry into the mind of the taxpayer revealed that the taxpayer actually had that other purpose as an object of the expenditure, then the fact that that result is a natural consequence of the expenditure will not cause that finding to be perverse (at [74]).
>
> 156. On the facts in *Scotts Atlantic* the Upper Tribunal concluded that a deduction was not available because "one purpose was to implement a pre-arranged scheme in order to obtain a tax deduction; the purpose was not simply to benefit employees and directors through the medium of an employment benefit scheme" (at [81])."

110. Judge Zaman sets out the principles established by the authorities and reasoning for the FTT's finding on this issue, as follows:

> "162. The expenses for which Strategic Branding claims a deduction are the contributions which were made to the RT (and these were the gross amounts of the contribution as resolved to be made by that company, out of which the fees were subsequently paid). I must therefore consider the principles established by the authorities, in particular:
>
> (1) whether the contributions were for the purpose of enabling Strategic Branding to carry on and earn profits in the trade;
>
> (2) this assessment must be based on the subjective intentions of Mr Wilson at the time of making the payments – these are not limited to his conscious motives, as some consequences are so inevitably and inextricably involved

> that (unless merely incidental) they must be taken to be a purpose for which the contributions were made;
>
> (3) if the expense was also incurred for some other (non-trade) purpose, it is not deductible;
>
> (4) the object must be distinguished from its effect - payments may be exclusively for the purposes of the trade even though they also secure a private benefit, if the securing of the private benefit was not the object but merely a consequential and incidental effect of the contributions; and
>
> (5) the question is not what was the object of the means of incurring the expense. The mere fact that a choice is influenced or dictated by the tax consequences does not necessarily mean that the choice involves a duality of purpose as regards the expense."

111. I agree with the approach taken by Judge Zaman in *Strategic*. Having regard for the principles established by the authorities, I must also consider whether the contributions were for the purpose of the trade, the subjective intentions of Mr Northwood at the time of making the payments, whether the expense was also incurred for some other (non-trade) purpose, the object of the payments (which must be distinguished from its effect) and the object of the means of incurring the expense.

112. On the basis of my factual findings in this case, I am not satisfied that the reasons for making contributions were for the purpose of the trade, namely to enter into a set of arrangements which gave Mr Northwood the protection that he wanted for business premises he was proposing to purchase and to benefit suppliers from his enhanced practice and good commercial relationship. My finding is that Mr Northwood's subjective intentions at the time of making the payments was to benefit himself and his family by obtaining tax advantages, including inheritance tax planning. I therefore consider the expense was incurred for a non-trade purpose and that securing of the private benefit was the object and not merely a consequential and incidental effect of the contributions. I accept that the mere fact that Mr Northwood's choice was influenced by the tax consequences does not necessarily mean that the choice involves a duality of purpose as regards the expense but, on this facts of this case, it is my finding that the expense was incurred for the non-trade purpose of securing a tax advantage.

113. Viewing these findings in the light of the authorities, I have concluded that the payments were for Mr Northwood's personal benefit and are not wholly and exclusively for the purposes of his trade. I do not consider the decision to use the RT arrangement could be said to be a permitted choice as to the means of incurring the expenditure and I have found there was a purpose of benefitting himself and his family, not just an effect.

FEES

114. With regard to the issue of whether Mr Northwood can claim a deduction for the fees of BW, Foy or any other facilitator of the arrangements, on the basis of my findings with regard to the purpose of the arrangements, I agree with HMRC that the fees were not incurred wholly and exclusively for the purpose of Mr Northwood's trade. Consequently, it is my finding that such fees are not allowable pursuant to section 34 ITTOIA 2005.

SHAM

115. Ms McCarthy submits that Mr Northwood intended, by virtue of the scheme documentation, to make things appear other than they were and that those documents were therefore a sham. Ms McCarthy does not accept that Mr Northwood was honest but contends that HMRC do not need to prove dishonesty to establish sham.

116. HMRC argues that the supposed purpose of benefitting suppliers was exposed as a work of fiction during cross-examination and the documents that Mr Northwood relied on to obtain a mortgage from NatWest exposed the true story, that the money remained within his control throughout and the only purpose of the scheme was tax avoidance. HMRC comment that it is noteworthy that those documents were obtained from NatWest by HMRC using its information powers and were not handed over by Mr Northwood during HMRC's enquiries. HMRC argue that Mr Northwood failed to identify a single person who was both a beneficiary of the arrangements, so far as Mr Northwood understood them to operate, and a person who fell within the class of beneficiaries under either the RT Deed and/or the Deed of Amendment, and that the only person who, in reality, was intended to benefit – and in fact did benefit – from the arrangements was Mr Northwood himself.

117. HMRC further contends that Mr Northwood's evidence, elicited in cross-examination, establishes that the Questionnaire was a sham because, although the document was designed to make it appear that Mr Northwood had considered the questions in it and completed it by reference to his business, the answers were in fact pro forma answers supplied by the promoter of the scheme and the alleged "obligations" owed to Mr Northwood's suppliers were never identified by Mr Northwood himself. Rather, the concept of "obligations" referred to in the Questionnaire simply formed part of the tax avoidance scheme package sold to Mr Northwood.

118. HMRC also argue that, contrary to the appearance given by the RT Deed, the Deed of Amendment, the Fiduciary Services Agreement and the Delegated Manager and Custodian Agreement, Mr Northwood remained at all times in control of any funds that he contributed to the RT. Mr Northwood's control over the funds was an integral part of the arrangements and is clearly set out in the slides provided by Mr Northwood to NatWest. Accordingly, HMRC argue, all that happened, in reality, was that Mr Northwood typically moved money from his first account to a second of his accounts (sometimes via BW's account), namely the MML account, without ever losing control of the funds and, as is now clear on the basis of Mr Northwood's own evidence, those funds were never intended to be, and were in fact not, subject to any trust for the benefit of Mr Northwood's suppliers and were never intended to be, and were in fact not, held by Trustees of any trust in a fiduciary capacity. HMRC contend that, notwithstanding the RT documents, in particular the RT Deed and Deed of Amendment, the funds remained Mr Northwood's funds and that in these circumstances the Tribunal should conclude that the RT documents were a sham.

119. Ms Brown submits that, while dishonesty is not a necessary element of sham, HMRC's case is that Mr Northwood was dishonest in the ordinary sense and, as the alleged shams are based on that alleged dishonesty, procedural safeguards should have been observed. Ms Brown further submits that, in order to prove the sham that HMRC allege, it is necessary to prove dishonesty and HMRC have both failed to do this given the standard of evidence required to do so and they have failed to put each of those documents to Mr Northwood.

120. To support her submissions, Ms Brown provided the Tribunal with a table setting out searches done on the transcripts of Mr Northwood's evidence. The search terms used were the name of each of the documents, variations of the names, and the words "mislead", "pretend", "pretence", "honest" and "dishonest". Ms Brown accepts that the search did not include all potentially relevant words, such as "truthful". Ms Brown's submission is that what Ms McCarthy put to Mr Northwood was that the documents were artificial, which is not the same as putting that it is a sham or dishonest, referring to *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63 at [67] where Arden LJ said:

> "the fact that the act or document is uncommercial, or even artificial, does not mean that it is a sham. A distinction is to be drawn between the situation where parties make an agreement which is unfavourable to one of them, or artificial,

> and a situation where they intend some other arrangement to bind them. In the former situation, they intend the agreement to take effect according to its tenor. In the latter situation, the agreement is not to bind their relationship."

121. Both parties referred to the decision in *Hockin*. With regard to the issue of sham in that case, the UT stated:

> "24. We agree with Mr Prosser that the FTT's finding of sham is a finding of fact and that we may interfere with it only on *Edwards v Bairstow* grounds (see *Edwards v Bairstow* [1956] AC 14 itself and the long line of authority following it). We are, however, conscious that a finding of sham, even if it does not imply dishonesty in the ordinary sense, necessarily requires the fact-finding tribunal to be satisfied of an intention to deceive or, at least, to make things appear other than as they are. This is a point to which we shall need to return; for the moment we merely observe that, because of this consideration, we have examined the detail of the FTT's findings with particular care.
>
> …
>
> 29. Mr Bremner is correct to say that the FTT did not make any finding of dishonesty; on the contrary, it described Mr Hardy, at [34], as "basically honest". We do not, however, and despite the note of caution we have sounded, consider that a finding of sham necessarily implies dishonesty. The pretence here was that 96 or 99 might have been spent on research, but the parties did not go further by pretending that it had in fact been spent on research. This was a tax avoidance, or deferral, scheme, and not evasion, and there was no attempt, as there would be in the case of evasion, to conceal what actually happened, however the parties chose to dress it up. One might disapprove of what was done; but we do not consider it could be said to have crossed the threshold into dishonesty."

122. Ms Brown expressed great difficulty with the distinction between an intention to deceive and an intention to make things appear other than as they are. Ms Brown's submission is that what was alleged and found in *Hockin* was that the document was drafted with an intention to make things appear other than as they were, namely that one of two things might happen when it was really only possible that one thing might happen, which is far from what is being alleged in this case. Ms Brown submits that *Hockin* found there to be two sorts of sham, an intention to deceive, which must require dishonesty, or an intention to make things appear other than they are and that can be described as not requiring dishonesty in the ordinary sense. Ms Brown contends that HMRC's case is clearly one of dishonesty. It is not a case of half concealment, which was the case in *Hockin*. Ms Brown submits that HMRC make a number of statements as to what the alleged real purpose of Mr Northwood's arrangements were, such as that the whole thing was a work of fiction, the only purpose of the arrangements was tax avoidance, the only person who was intended to benefit was Mr Northwood, contrary to the appearances of various documents such as the trust deed, Mr Northwood retained control of the funds at all relevant times and that the funds were never subject to the trust, were never held or intended to be held by anyone in a fiduciary capacity and remained Mr Northwood's property and in his control. This therefore is not an allegation that Mr Northwood said "well, we might do this or we might do that" when Mr Northwood clearly only intended to do one thing. The allegation, Ms Brown submits, is that Mr Northwood created documents to give one appearance and then did something completely different. Ms Brown contends that is an allegation of dishonesty and it is not open to the Tribunal to make a finding of dishonesty, because those allegations of dishonesty have neither been properly pleaded nor properly put to Mr Northwood in cross-examination.

123. I have considered Ms Brown's arguments regarding pleading sham at [42] to [49] above. I do not accept Ms Brown's submission that the way in which HMRC have put their case requires proof of dishonesty. It is clear that HMRC do not consider Mr Northwood to have been honest. However, in my view, this case falls within the category described in *Hockin* as a pretence that does not cross the threshold into dishonesty. My finding is that the RT documentation was dressed up to achieve a tax benefit but this was "not evasion, and there was no attempt, as there would be in the case of evasion, to conceal what actually happened, however the parties chose to dress it up".

124. I also do not agree that HMRC did not put the sham allegation to Mr Northwood in cross-examination. The questions put to Mr Northwood did not simply suggest the situation where parties made an agreement which was unfavourable to one of them, or artificial. The questions were put in the context of a situation where the parties intended some other arrangement. I therefore find that the allegations were put fairly and squarely to Mr Northwood and that he was given an opportunity to rebut them.

125. With regard to the scheme documentation, I am satisfied, on the basis on my factual findings above, that there was a common intention to make things appear other than as they are. I therefore find the documentation relating to the RT, referred to at [75] to [78] above, to be a sham.

CONCLUSION

126. I find that the contributions made to the RT, together with any associated fees, are not deductible in calculating Mr Northwood's taxable profits because the contributions should not have been recognised as an expense in the accounts under UK GAAP and the contributions and associated fees were not wholly and exclusively for the purposes of the trade. I also find that there was an intention, by virtue of the RT documentation, to make things appear other than they were and the documentation was therefore a sham.

127. Accordingly, and for the reasons set out above, the appeal is dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

128. 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.

KIM SUKUL
TRIBUNAL JUDGE

RELEASE DATE: 21 March 2023