Appeal number
FTC/47/2010

Income Tax – Schedule D – computation of profits – section 42 FA 1998 – whether accounts prepared in accordance with generally accepted accounting practice – sections 29, 34, 36 TMA 1970 – whether negligent conduct if accounts not prepared in accordance with generally accepted accounting practice – whether HMRC discovered tax loss

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

LESLIE SMITH **Appellant**

- and –

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

Tribunal: The Hon Mr Justice Arnold

Sitting in public in London on 11 and 12 April 2011

Dr David Southern, instructed by Bright & Sons, for the Appellant

Hui Ling McCarthy, instructed by HMRC Solicitor's Office, for the Respondents

MR JUSTICE ARNOLD:

Introduction

1. This is an appeal from a decision of the First-Tier Tribunal (Tax) (Charles Hellier and John Cherry) ("the Tribunal") dated 24 February 2010 [2010] UKFTT 92 (TC) by which the Tribunal dismissed the appeal of Leslie Smith ("Mr Smith") against decisions of the Commissioners for Her Majesty's Revenue and Customs ("HMRC") to make (a) assessments to his 1997/98, 1998/99 and 1999/2000 income tax returns pursuant to sections 29 and 36 of the Taxes Management Act 1970 ("TMA 1970"), (b) an amendment to his 2000/01 income tax return pursuant to section 28A TMA 1970 and (c) an assessment to his 2001/02 income tax return pursuant to section 29 TMA 1970. It should be noted that the effect of the amendment to the 2000/01 return was to *reduce* the tax payable in that year, but the reason for the reduction in that year was the same as the reason for the increased assessments in the other years.

2. In a nutshell, the Tribunal decided that the way in which Mr Smith's accountants had prepared his accounts for each of those years was in two respects not in accordance with generally accepted accounting practice at the relevant time, and that this constituted "negligent conduct" by a person acting on Mr Smith's behalf which resulted in a tax loss that HMRC had "discovered". Mr Smith appeals against the Tribunal's decision in relation to the date at which income was recognised in his accounts. He does not challenge the Tribunal's decision in relation to the manner in which stock and work in progress was treated in the accounts.

3. The Tribunal also allowed appeals by Mr Smith against assessments in respect of his 1994/95, 1995/96 and 1996/97 returns. There is no cross-appeal by HMRC in respect of this aspect of the decision, and I shall say no more about it.

The legal framework

4. For the tax years 1997/98 to 1999/2000, the common law principle was that the profits and losses of a business for tax purposes were those determined by applying "the correct principles of the prevailing system of commercial accountancy" unless there was some statutory or judge-made rule which displaced those principles: see Pennycuick V-C in *Odeon Associated Theatres Ltd v Jones* (1971) 48 TC 257 at 273 and Sir Thomas Bingham MR (as he then was) in *Gallagher v Jones* [1993] STC 537 at 554. The courts recognised that, in some situations, there could be more than one method of accounting for particular items that was in accordance with sound principles of commercial accounting: see Lord Fraser of Tullybelton and Lord Keith of Kinkel in *Willingale v International Commercial Bank Ltd* (1978) 52 TC 242 at 272, 280 and Knox J in *Johnston v Britannia Airways Ltd* [1994] STC 753 at 782.

5. For periods of account beginning after 6 April 1999 (i.e. for 2000/01 and 2001/02), section 42(1) of the Finance Act 1998 ("FA 1998") provided:

"For the purposes of Case I or II of Schedule D, the profits of a trade, profession or vocation must be computed on an accounting basis which gives a true and fair view subject to any adjustment required or authorised by law in computing profits for those purposes."

6. At the times material to this appeal, there was no definition of "a true and fair view". (Subsequently, section 42(1) FA 1998 was amended by section 103(5) of the Finance Act 2002 ("FA 2002") with effect from 24 July 2002 to replace the words "on an accounting basis which gives a true and fair view" by "in accordance with generally accepted accounting practice". At the same time, section 103(2) FA 2002 inserted section 836A into the Income and Corporation Taxes Act 1988 to define "generally accepted accounting practice". These amended provisions do not apply to any of the accounting periods in issue, however.) It was common ground before me that section 42(1) FA 1998 did not exclude the possibility that there could be more than one accounting basis which gave a true and fair view.

7. Section 29 TMA 1970 at it stood at the material times provided, so far as is relevant:

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

(a) that any income which ought to have been assessed to income tax ... [has] not been assessed or

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

...

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

…

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

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

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

unless one of the two conditions mentioned below is fulfilled.

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

8. Section 34(1) TMA 1970 provided that no assessment may be made later than five years after the 31 January next following the year of assessment to which the appeal relates. But this was subject to an extended time limit of 20 years pursuant to section 36(1) TMA 1970 in the case of "an assessment … for the purpose of making good to the Crown a loss of income tax … attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf".

The accounting standards

9. As the Tribunal recorded in paragraph 59 of its decision:

> "Each of the accountants who appeared before us accepted that it was mandatory to follow applicable published accounting standards in the preparation of accounts designed to give a true and fair view. It was clear to us that the accounting standards which were in force at any time formed the basis for generally accepted accounting practice at that time, and if the actual accounts prepared for an enterprise differed materially from accounts which had been prepared on the basis of those standards, then those actual accounts would not show a true and fair view unless there were exceptional circumstances justifying a departure from the standards in order to ensure the presentation of a true and fair view."

10. The Tribunal referred in its decision in relation to the income recognition issue to a number of UK accounting standards and one international accounting standard.

SSAP 2

11. Statement of Standard Accounting Practice 2 "Disclosure of accounting policies" ("SSAP 2") was issued by the Accounting Standards Committee ("ASC") in November 1971 with effect for accounting periods starting on or after 1 January 1972. It remained the principal relevant accounting standard for the years 1997/98 to 2000/01.

12. As explained in paragraphs 1-4 and 14-16, SSAP 2 distinguished between "fundamental accounting concepts", "accounting bases" and "accounting policies". Fundamental accounting concepts are broad basic assumptions which underlie the periodic financial accounts of business enterprises, accounting bases are the methods which have been developed for expressing or applying fundamental accounting concepts to financial transactions and items and accounting policies are the specific accounting bases judged by business enterprises to be most appropriate to their circumstances and adopted by them for the purpose of preparing their accounts.

13. Paragraph 14 defined four "fundamental accounting concepts", including the "accruals" concept, the "consistency" concept and the "prudence" concept:

> "(b) the 'accruals' concept: revenue and costs are accrued (that is, recognised as they are earned or incurred, not as money is received or paid), matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account to which they relate; provided that where the accruals concept is inconsistent with the 'prudence' concept (paragraph (d) below), the latter prevails. The accruals concept implies that the profit and loss account reflects changes in the amount of net assets that arise out of the transactions of the relevant period … . Revenue and profits dealt with in the profit and loss account are matched with associated costs and expenses by including in the same account the costs incurred in earning them (so far as these are material and identifiable);
>
> (c) the 'consistency' concept: there is consistency of accounting treatment of like items within each accounting period and from one period to the next;
>
> (d) the concept of 'prudence': revenue and profits are not anticipated, but are recognised by inclusion in the profit and loss account only when realised in the form either of cash or other assets the ultimate cash realisation of which can be assessed with reasonable certainty; provision is made for all known liabilities (expenses and losses) whether the amount of these is known with certainty or is a best estimate in the light of the information available."

14. SSAP 2 did not require that financial statements be prepared in accordance with these fundamental concepts; but if accounts were prepared on the basis of assumptions which differed in material respects from any of the fundamental concepts defined in paragraph 14, paragraph 17 required a clear statement to that effect.

FRS 18

15. Financial Reporting Standard 18 "Accounting Policies" ("FRS 18") was issued by the Accounting Standards Board Ltd ("ASB") in December 2000. It replaced SSAP 2 with effect for accounting periods ending on or after 22 June 2001. It was therefore applicable only to Mr Smith's 2001/02 accounts.

16. FRS 18 included the following passages:

> "*Accounting policies and financial statements*
>
> 14. An entity should adopt accounting policies that enable its financial statements to give a true and fair view. Those accounting policies should be consistent with the requirements

of accounting standards, Urgent Issues Task Force (UITF) Abstracts and companies legislation.

…

17. Where it is necessary to choose between accounting policies that satisfy the conditions in paragraph 14, an entity should select whichever of those accounting policies is judged by the entity to be most appropriate to its particular circumstances for the purposes of giving a true and fair view.

…

Accruals

26. An entity should prepare its financial statements, except for cash flow information, on accruals basis of accounting.

27. The accruals basis of accounting requires the non-cash effects of transactions to be reflected so far as possible in the financial statements for the accounting periods in which they occur and not, for example, in the period in which any cash involved is received or paid. The accruals concept lies at the heart of the definitions of assets and liabilities, which are set out in FRS 5 'Reporting the Substance of Transactions'. Accordingly, the use of those definitions to determine items to be recognised in an entity's balance sheet is consistent with the accruals concept.

Realisation

28. In preparing financial statements an entity will have regard to requirements in companies legislation that only profits realised at the balance sheet should be included in the profit and loss account. Companies legislation requires realised profits to be determined in accordance with principles generally accepted at the time that financial statements are prepared. It is generally accepted that profits shall be treated as realised for these purposes only when realised in the form either of cash or other assets the ultimate cash realisation of which can be assessed with reasonable certainty."

17. FRS 18 thus differed from SSAP 2 in requiring the use of the accruals basis of accounting.

FRS 5

18. Financial Reporting Standard 5, "Reporting the Substance of Transactions" ("FRS 5") was issued by the ASB in April 1994. It applied to financial statements relating to accounting periods ending on or after 22 September 1994.

19. The salient parts of FRS 5 were as follows:

> "**SUMMARY**
>
> **General**
>
> a. Financial Reporting Standard 5, 'Reporting the Substance of Transactions' requires an entity's financial statements to report the substance of the transactions into which it had entered. The FRS sets out how to determine the substance of a transaction (including how to identify its effect on the assets and liabilities of the entity), whether any resulting assets and liabilities should be included in the balance sheet, and what disclosures are appropriate. …
>
> b. The FRS will not change the accounting treatment and disclosure of the vast majority of transactions. It will mainly affect those more complex transactions whose substance may not be readily apparent. The true commercial effect of such transactions may not be adequately expressed by their legal form and, where this is the case, it will not be sufficient to account for them merely by recording that form.
>
> …
>
> **Objective**
>
> 1. The objective of this FRS is 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.
>
> **Definitions**
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> …
>
> 2. *Assets:-*
>
> Rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.
>
> …
>
> **SCOPE**
>
> 11. Subject to paragraph 12. Financial Reporting Standard 5 applies to all transactions of a reporting entity whose financial statements are intended to give a true and fair view of its financial position and profit or loss (or income and expenditure) for a period. …
>
> **GENERAL**

The substance of transactions

14. A reporting entity's financial statements should report the substance of transactions into which it has entered. In determining the substance of a 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.

…

THE SUBSTANCE OF TRANSACTIONS

Identifying assets and liabilities

16. 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.

17. Evidence that an entity has rights or other access to benefits (and hence has an asset) is given if the entity is exposed to the risks inherent in the benefits, taking into account the likelihood of those risks having a commercial effect in practice.

…

Recognition of assets and liabilities

20. 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."

20. Appendix III "The development of the FRS" included the following passages:

"1. The problems of what is commonly referred to as 'off balance sheet financing' became evident during the 1980s. In that period, a number of complex arrangements were developed that, if accounted for in accordance with their legal form, resulted in accounts that did not report the commercial effect of the arrangement. …

2. At the same time, there was rapid innovation in financial markets. New arrangements for financing assets were

developed, the accounting for which was not immediately obvious. …

3. These developments raised fundamental questions about the nature of assets and liabilities and when they should be included in the balance sheet. …

4. The FRS has been developed to address these issues and to deal with the problems caused by the misleading effects that 'off balance sheet financing' can have on the accounts….."

FRS 5 AN G

21. FRS 5 Application Note G "Revenue Recognition" ("FRS 5 AN G") was issued by the ASB with effect from 1 November 2003. As such, it did not apply to any of the accounting periods in issue. It is nevertheless relevant to the appeal for the reasons explained below.

22. FRS 5 AN G included the following paragraphs:

"**Basic Principles**

G4. A seller receives revenue under an exchange transaction with a customer, when, and to the extent that, it obtains the right to consideration in exchange for its performance. At the same time, it typically recognises a new asset, usually a debtor.

…

G6. A seller may obtain a right to consideration when some, but not all, of its contractual obligations have been fulfilled. Where a seller has partially performed its contractual obligations, it recognises revenue to the extent that it has obtained the right to considerations through its performance."

23. Appendix III to FRS 5 AN G stated at paragraph 1:

"The absence of a UK standard dealing explicitly with revenue recognition has been a source of muted criticism for some time. Different entities and industries have followed practices that are in some respects inconsistent with one another. More generally, there are different views of what revenue is or represents, and of how financial statements should portray a business's operating activities.

In practice, those seeking guidance on whether or when to recognise revenue have turned to International Accounting Standards (IAS) or accounting standards adopted in the United States. The international standard, IAS 18 'Revenue', was originally issued in 1982 and substantially revised in 1993. …"

UITF 40

24. Urgent Issue Task Force Abstract 40, "Revenue Recognition and Service Contracts" ("UITF 40") was issued by the ASB's Urgent Issue Task Force ("UITF") on 10 March 2005 with effect for accounting periods ending on or after 22 June 2005. Again, it therefore did not apply to any of the accounting periods in issue. It is nevertheless relevant for the reasons explained below.

25. Paragraph 1 of UITF 40 explained the background to it in the following terms:

> "Since the ASB issued Application Note G: Revenue Recognition, as an Amendment to FRS 5, 'Reporting the Substance of Transactions' ('Application Note G') in November 2003, questions have arisen about the accounting for revenue (ie turnover) from contracts to provide services, and the UITF has been asked to provide guidance. Although many of these requests specifically refer to services rendered by professional service firms (for example, firms of accountants and solicitors), the UITF believes the same principles should be applied in accounting for all service contracts. This Abstract therefore applies to all contracts for services."

26. Paragraphs 16 and 19 stated:

> "16. The UITF takes the view that Application Note G requires all contracts for services to be accounted for in accordance with its general principles, including those stated in paragraphs 5 to 7 above. The overriding consideration is whether the seller has performed, or partially performed, its contractual obligations. If it has performed some, but not all, of its contractual obligations, it is required to recognise revenue to the extent that it has obtained the right to consideration through its performance.
>
> …
>
> 19. Where the substance of a contract is that a right to consideration does not arise until the occurrence of a critical event, revenue is not recognised until that event occurs. This only applies where the right to consideration is conditional or contingent on a specified future event or outcome, the occurrence of which is outside the control of the seller."

SSAP 17

27. Statement of Standard Accounting Practice 17 "Accounting for post balance sheet events" ("SSAP 17") was issued by the ASC in August 1980 with effect in relation to accounting periods beginning on or after 1 September 1980.

28. Paragraph 1 of the explanatory notes stated:

> "Events arising after the balance sheet date to be reflected in financial statements if they provided additional evidence of conditions that existed at the balance sheet date and materially affect the amounts to be included."

29. Paragraph 18 defined "post balance sheet events" as "events …. which occur between the balance sheet date and the date on which the financial statements are approved by the board of directors" and paragraph 19 defined "adjusting events" as "post balance sheet events which provide additional evidence of conditions existing at the balance sheet date". Paragraph 22 stated:

> "A material post balance sheet event requires changes in the amounts to be included in financial statements where:
>
> (a) it is an adjusting event; …"

IAS 18

30. International Accounting Standard 18 "Revenue" was issued by the International Accounting Standards Board in 1982 and revised in 1993. Under the heading "Objective" it stated:

> "The primary issue in accounting for revenue is determining when to recognise revenue. Revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised."

Paragraphs 20-28 of IAS 18 dealt with the rendering of services.

The facts

31. The facts relating to Mr Smith's business and his accounts are set out in some detail in the Tribunal's decision at paragraphs 35-57. Omitting reference to the facts relating to the stock and work in progress issue, they may be summarised as follows.

32. In all the years in question, Mr Smith traded as sole trader. His accounting period was the same as the tax year i.e. 6 April to 5 April. He carried on business as a subcontractor undertaking ground works for construction companies. The contracts were generally fixed price contracts for carrying out works over a period of between a month and a year. The typical length of contract was two to three months. He had a number of employees.

33. At the end of the contract, or sometimes at intervals during the contract, Mr Smith would make an *application for payment* to the main contractor. The application for payment would be based on an assessment made by a quantity surveyor employed by Mr Smith. Within a week or so of the application for payment, the contractor's quantity surveyor would visit the site and inspect the work. The contractor would then issue a *valuation certificate* based on its quantity surveyor's assessment. Payment would generally be made by the

contractor some 30 days after the application for payment and about two weeks after the issue of the valuation certificate. It is common ground that no debt was due and owing to Mr Smith until the valuation certificate was issued. Importantly, however, the Tribunal found at paragraph 47 that "the sums requested in applications for payment were generally paid in full or in amounts which varied by only a few percent from the amounts claimed".

34. From 1997 onwards Mr Smith employed Maynard Heady to prepare his annual accounts and tax returns. Gary Tidbury FCA was the partner responsible. In preparing Mr Smith's accounts, Mr Tidbury took the view that income could not be recognised when the application for payment was made, but only when the valuation certificate was issued.

35. The issue on this appeal is whether income should be recognised when the application for payment was made or when the valuation certificate was issued. This issue only matters in cases where the application for payment was made before 5 April, but the valuation certificate was issued after 5 April. In those circumstances, a question arises as to which accounting period and tax year the income should be recognised in. If both events occurred in the same accounting period and tax year, it does not matter whether income is recognised when the application for payment was made or when the valuation certificate was issued.

36. In 2002 Mr Smith transferred his business to a limited company. Accordingly, profits generated after 5 April 2002 were the subject of that company's returns.

37. The Tribunal set out the facts relating to the "discovery" issue in paragraphs 4-10 and 105-109. Again omitting reference to the stock and work in progress issue, they may be summarised as follows.

38. On 14 January 2003 Mr Cotton of HMRC opened an enquiry into Mr Smith's 2000/01 tax return. This was within the time limit imposed by section 9A TMA 1970. Thereafter Mr Cotton received copies of underlying documents. After a visit to Maynard Heady, Mr Cotton concluded that the accounts did not properly state Mr Smith's profits for 2000/01. He discussed this with Mr Tidbury, who explained that income was not recognised until the valuation certificate was issued. Mr Tidbury also told Mr Cotton that this was a practice he had adopted in relation to earlier years. Mr Cotton was also told about the transfer of Mr Smith's business, as a result of which he made enquiries of the inspector dealing with the company's returns and discovered that there were a number of receipts after 5 April 2002 by that company which reflected work done by Mr Smith before that date.

39. On 21 October 2004 Mr Cotton opened an enquiry into Mr Smith's 2001/02 tax return, but this was outside the time limit imposed by section 9A. On 13 December 2005 HMRC issued an assessment for 2001/02 relying on section 29 TMA 1970. On 2 February 2006 HMRC issued assessments for 1997/98, 1998/99 and 1999/2000 relying upon section 29 and (in the case of 1997/98 and 1998/99) section 36 TMA 1970. Also on 2 February 2006 HMRC issued a

closure notice in respect of the 2000/01 enquiry which amended the return for that year so as to reduce the assessed profits.

The Tribunal's decision

40. In its decision the Tribunal set out the background to the appeals at paragraphs 1-10, the law at paragraphs 11-32, the facts relating to Mr Smith's business at paragraphs 35-57 and the various accounting standards at paragraphs 58-74. Having considered SSAP 2 and FRS 5 in paragraphs 62-65, the Tribunal concluded at paragraph 66:

> "It is clear to us therefore that, save in exceptional circumstances, after 1994 accounts which were to show a true and fair view had to be prepared upon the accruals basis and that that basis required the recognition of assets (as access to future economic benefits controlled by the entity) where there was sufficient evidence of the existence of those assets and they could be measured as monetary amounts with sufficient reliability."

41. Having considered the accountancy evidence at paragraphs 75-93, the Tribunal set out its conclusions in relation to the two accounting issues at 94-104. In view of the arguments before me, it is necessary to quote the Tribunal's conclusions in relation to income recognition in full:

> "96. It seems to us that FRS 5, AN G and UITF 40 addressed issues in the penumbra of the accounting practice required by FRS 5 in relation to the recognition of assets. At the margin there were uncertainties and various policies were capable of being applied: if the contract was not complete when should the work done be regarded as an asset? SSAP 9 had provided guidance on recognising profit in long-term contracts, but what about short-term ones: should profit be recognised only when all stages of the contract had been completed? when only one stage had been completed? when that stage was substantially complete? or by reference to the proportion of work completed? But it was clear that when the contract had been completed an asset should be recognised because then the entity had access to the economic benefit of expected payment under the contract.
>
> 97. In relation to issues in the penumbra there was, prior to AN G and UITF 40, scope for judgement in determining the policy to be applied. But in relation to routine issues, the requirements of the standard were clear and there was no scope for judgement. We accept Mr Mathew's evidence on this issue which is consistent with the accounting pronouncements we have related.
>
> 98. It seems to us that Mr Elsworth's reference to IAS 18 and the history recorded in FRS 5, AN G that it had been used for

guidance, indicates an acceptance of its principles as an authoritative way in which judgement at the margin could be exercised. The thrust of IAS 18 is that revenue may be recognised *before* a transaction was complete if there is reliable evidence. It was therefore implicit that the revenue and asset would be recognised when the transaction was complete. We accept Mr Elsworth's evidence that the recognition of assets and revenue in relation to the work done by a business such as that of Mr Smith was not at the margin of the application of the standards.

99. It seems to us that a *policy* not to recognise an asset until the customer had issued its valuation certificate would not accord with the requirements of FRS 5 unless there were exceptional circumstances justifying departure. Such a policy would thus not be generally accepted accounting policy. The only circumstance offered justifying departure from FRS 5 was the nature of the industry in which Mr Smith did business. But the issue in each case is whether an entity's accounts present a true and fair view, not whether they are prepared consistently with the policies adopted by other entities in the same industry. We conclude that there were no circumstances justifying departure.

100. It seems to us that the practice used in Mr Smith's accounts could be described in two ways:

a. that as a matter of accounting policy assets representing work done were not recognised until the customer issued its certificate; or

b. assets would be recognised when access to economic benefits controlled by Mr Smith arose but only when they could be determined reliably.

101. If it was the first for the reasons we have set out it would not be generally accepted accounting policy.

102. On the alternative basis one says that, although the accounts applied GAAP policies they were prepared on the basis that there was insufficient evidence to recognise the access to future benefits represented by the application for payment made before the year-end but not reflected in customers' valuation certificates.

103. It seems to us that this approach does not in the circumstances comply with generally accepted accounting *practice*. That is because SSAP 17 forms part of generally accepted accounting practice and should have been followed. The application of SSAP 17 required the consideration of whether there were events after the balance sheet date which gave additional evidence of circumstances existing at that date. Such evidence

> was available in the form of the receipt of payments relating to the future benefits represented by the applications for payment. Those receipts were adjusting events indicating that the applications for payment should be valued at their full amount. Thus there was a failure to comply with SSAP 17."

42. At paragraph 104 the Tribunal concluded that the policy which Mr Tidbury had adopted in relation to stock and work in progress was not in accordance with the applicable standard, Statement of Standard Accounting Practice 9. As noted above, there is no appeal against this part of the Tribunal's decision.

43. The Tribunal went on to conclude that Mr Cotton had discovered an understatement of profits leading to a loss of tax in relation to the years 1997/98, 1998/99, 1999/2000 and 2001/02 (paragraphs 105-109); and that the manner in which Mr Tidbury had prepared the accounts with regard to (a) stock and work in progress and (b) income recognition amounted to negligent conduct (paragraph 110).

44. Finally, the Tribunal set out its adjustments to the five sets of accounts (paragraphs 111-115). There is no challenge by either party to the Tribunal's calculations, according to which the total sum payable by Mr Smith (in addition to his self assessments) is £233,920. This total takes into account an overpayment by Mr Smith of £55,584 in 2000/01.

The appeal

45. Mr Smith appeals on three main grounds. First, he contends that no reasonable tribunal properly directed as to the law could have concluded from the evidence that the only correct point at which to recognise income was when the application for payment was made rather than when the valuation certificate was issued. Instead, the only conclusion which the Tribunal was entitled to reach was that both methods were acceptable methods of commercial accounting at the relevant dates. Secondly, he contends that the Tribunal exceeded its jurisdiction in making a finding of professional negligence on the part of Mr Tidbury, or at least applied the wrong test for "negligent conduct". Thirdly, he contends that the Tribunal was wrong to conclude that HMRC had "discovered" a tax loss in relation to the years 1997/98 to 1999/2000 and 2001/2002 since it made no findings of fact which could support such a conclusion, or at least which supported its conclusion in relation to the three earlier years.

The nature of an appeal to this tribunal

46. Section 11(1) of the Tribunals, Courts and Enforcement Act 2007 provides for a right of appeal to the Upper Tribunal "on any point of law arising from a decision made by the first tier tribunal other than an excluded decision". It was common ground before me that the principles established under section 11(1) of the Tribunals and Inquiries Act 1992 and its predecessors were equally applicable under section 11(1) of the 2007 Act.

47. In *Edwards v Bairstow* [1956] AC 14 Viscount Simonds said at 29:

> "… though it is a pure finding of fact, it may be set aside on grounds which have been stated in various ways but are, I think, fairly summarised by saying that the court should take that course if it appears that the commissioners have acted without any evidence or upon a view of the facts which could not reasonably be entertained."

Lord Radcliffe said at 36:

> "If the case contains anything ex facie which is bad law and which bears upon the determination, it is obviously, erroneous in point of law. But, without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene."

48. In *Georgiou v Customs and Excise Commissioners* [1996] STC 463 Evans LJ, with whom Saville and Morritt LJJ (as they then were) agreed, said at 476:

> "There is a well-recognised need for caution in permitting challenges to findings of fact on the ground that they raise this kind of question of law. … It is all too easy for a so-called question of law to become no more than a disguised attack on findings of fact which must be accepted by the courts. As this case demonstrates, it is all too easy for the appeals procedure to the High Court to be abused in this way. Secondly, the nature of the factual inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact. The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but was there evidence before the tribunal which was sufficient to support the finding which it made? In other words, was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled.
>
> It follows, in my judgment, that for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make. What is not permitted, in my view, is a roving selection of the evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong."

49. In *Procter & Gamble UK v Revenue and Customs Commissioners* [2009] EWCA Civ 407, [2009] STC 1990 Jacob LJ, with whom Mummery and Toulson LJJ agreed, said:

> "9. Often a statutory test will require a multi-factorial assessment based on a number of primary facts. Where that it so, an appeal court (whether first or second) should be slow to interfere with that overall assessment – what is commonly called a value-judgment.
>
> 10. I gathered together the authorities about this in *Rockwater v Technip* [2004] EWCA Civ 381:
>
> > [71] … In *Biogen v Medeva* [1997] RPC 1 at p. 45 Lord Hoffmann said when discussing the issue of obviousness:
> >
> > 'The need for appellate caution in reversing the judge's evaluation of the facts is based upon much more solid grounds than professional courtesy. It is because specific findings of fact, even by the most meticulous judge, are inherently an incomplete statement of the impression which was made upon him by the primary evidence. His expressed findings are always surrounded by a penumbra of imprecision as to emphasis, relative weight, minor qualification and nuance (as Renan said, *la vérité est dans la nuance*), of which time and language do not permit exact expression, but which may play an important part in the judge's overall evaluation. It would in my view be wrong to treat *Benmax* as authorising or requiring an appellate court to undertake a *de novo* evaluation of the facts in all cases in which no question of the credibility of witnesses is involved. When the application of a legal standard such negligence or obviousness involves no question of principle but is simply a matter of degree, an appellate court should be very cautious in differing from the judge's evaluation.'
> >
> > [72] Similar expressions have been used in relation to similar issues. The principle has been applied in *Pro Sieben Media v Carlton* [1999] 1 WLR 605 at pp. 613-614 (*per* Robert Walker LJ) in the context of a decision about 'fair dealing' with a copyright work; by Hoffmann LJ in *Re Grayan Building Services* [1995] Ch 241 at p.254 in the context of unfitness to be a company director; in *Designer Guild v Russell Williams* [2000] 1 WLR 2416 in the context of a substantial reproduction of a copyright work and, most recently in *Buchanan v Alba Diagnostics* [2004] UKHL 5 in the context of whether a particular invention was

> an 'improvement' over an earlier one. Doubtless there are other examples of the approach.
>
> [73] It is important here to appreciate the kind of issue to which the principle applies. It was expressed this way by Lord Hoffmann in *Designer Guild:*
>
> 'Secondly, because the decision involves the application of a not altogether precise legal standard to a combination of features of varying importance, I think that this falls within the class of case in which an appellate court should not reverse a judge's decision unless he has erred in principle.'
>
> 11. It is also important to bear in mind that this case is concerned with an appeal from a specialist Tribunal. Particular deference is to be given to such Tribunals for Parliament has entrusted them, with all their specialist experience, to be the primary decision maker, see per Baroness Hale in *AH (Sudan) v Secretary of State for the Home Department* [2007] UKHL 49, [2008] 1 AC 678 at [30] …."

50. What Baroness Hale said in *AH (Sudan),* which has since been approved by Sir John Dyson SCJ giving the judgment of the Supreme Court in *MA (Somalia) v Secretary of State for the Home Department* [2007] UKSC 49, [2011] 2 All ER 65 at [43], was this:

> " … This is an expert tribunal charged with administering a complex area of law in challenging circumstances. To paraphrase a view I have expressed about such expert tribunals in another context, the ordinary courts should approach appeals from them with an appropriate degree of caution; it is probable that in understanding and applying the law in their specialised field the tribunal will have got it right: see *Cooke v Secretary of State for Social Security* [2002] 3 All ER 279, para 16. They and they alone are the judges of the facts. It is not enough that their decision on those facts may seem harsh to people who have not heard and read the evidence and arguments which they have heard and read. Their decisions should be respected unless it is quite clear that they have misdirected themselves in law. Appellate courts should not rush to find such misdirections simply because they might have reached a different conclusion on the facts or expressed themselves differently. … "

<u>General observations with regard to the present appeal</u>

51. It is convenient to begin with some general observations with regard to the present appeal before turning to the specific grounds.

52. First, the Tribunal recorded in paragraph 58 of its decision:

> "Both members of the tribunal were chartered accountants. Mr Hellier had ceased to practice as such in the 1980s. Mr Cherry was still in practice. Although our experience and training illuminated the evidence before us, we relied on the evidence of the witnesses and the terms of the accounting standards in reaching our conclusions. We did not substitute our own understanding for that provided in the evidence before us."

The Tribunal was thus a specialised tribunal not merely by virtue of its function, but also by virtue of the expertise of its members. That is significant in the present case because the central issue which it faced was whether Mr Smith's accounts had been prepared in accordance with generally accepted accounting practice. It follows, for the reasons given above, that particular deference is to be given to its decision.

53. Secondly, the Tribunal's decision was given after a four day hearing at which a number of witnesses gave oral evidence. In addition to Mr Smith, these included Mr Tidbury and two expert witnesses, Lee Elsworth FCA (for Mr Smith) and Anil Mathew FCCA (for HMRC). In its decision the Tribunal considered the evidence of each of the three accountants in detail. This tribunal does not have the advantage, which the Tribunal did have, of seeing the witnesses give evidence. It follows, for the reasons given above, that this tribunal should be slow to conclude that the Tribunal was not entitled to reach the conclusions it reached. This is particularly so given that the Tribunal stated that it was "not impressed by Mr Tidbury's evidence" for four reasons which it gave in paragraph 77. These reasons were, in short, that in a number of respects Mr Tidbury's evidence to the Tribunal and his explanations of the accounting policies he had adopted did not properly reflect the relevant accounting standards. The Tribunal was particularly critical of an explanation Mr Tidbury gave for the treatment of one item of work in progress, describing it as "inconsistent and incredible".

54. Thirdly, counsel for HMRC submitted that in reality the appeal was an attempt by Mr Smith to re-argue questions of fact and evaluation which had been decided by the Tribunal with a view to trying to persuade this tribunal to take a different view. In my judgment this submission is well founded. I was particularly struck by two matters. The first was the fact that, in his skeleton argument, counsel for Mr Smith suggested that, by way of advance reading for the appeal, this tribunal should read the evidence of no less than five witnesses, including the three accountants. As I informed counsel at the outset of the hearing, I did not do so, since I did not consider it a proper way in which to approach the appeal. What I did not appreciate at that stage was that the appeal bundles only included the witnesses' witness statements and expert reports, and not a transcript or note of their oral evidence. Thus counsel's suggestion amounted to an invitation to read just the written evidence, and not the evidence given orally. That would inevitably have left me with a false impression of the totality of the evidence of those witnesses. The second was that, in opening the appeal, counsel for Mr Smith made two assertions about the evidence of Mr Mathew which counsel for HMRC was able to demonstrate by reference to a note of his oral evidence were inaccurate. I am not

suggesting for one moment that counsel for Mr Smith intended to mislead this tribunal. It is easy to forget or misremember oral evidence given at a hearing over 16 months ago when one does not have a transcript or note of it. But this episode illustrates the dangers involved if an appeal to this tribunal is not kept within its proper confines.

55. Fourthly, counsel for HMRC argued that Mr Smith's challenge to the Tribunal's conclusions in relation to income recognition was inconsistent with his failure to appeal their conclusions in relation to stock and work in progress. I agree that there is an inconsistency, but I accept counsel for Mr Smith's explanation that the amount of money involved in relation to stock and work in progress is small and thus the matter was not worth pursuing on appeal.

First ground of appeal: more than one permissible method of accounting

56. As noted above, Mr Smith's first ground of appeal is that no reasonable tribunal properly directed as to the law could have concluded from the evidence that the only correct point at which to recognise income was when the application for payment was made, and accordingly the Tribunal's contrary conclusion was wrong in law. Counsel for Mr Smith made various general points in support of this ground of appeal, but particularly relied on three specific criticisms of the Tribunal's reasoning.

General points

57. Counsel for Mr Smith's first point was that at the relevant times there was no UK accounting standard for income recognition. Indeed, even now there is no general accounting standard for income recognition. The first applicable standards dealing with income recognition were FRS 5 AN G and UITF 40, both of which came into force after the relevant accounting periods. Accordingly, he argued, at the relevant time the question of when to recognise income was necessarily a matter for professional judgement. Indeed, the introduction of FRS 5 AN G and UITF 40 confirmed that previously there was room for more than one view. Secondly, he submitted that both approaches (recognising income when the application for payment was made and when the valuation certificate was issued) were supported by expert professional opinion, and thus it could not be said that only the former approach was correct. Thirdly, he argued that this was supported by evidence, which the Tribunal accepted, that it was common practice to adopt the latter approach in construction industry accounts at the time. Fourthly, he contended that Mr Tidbury had deliberately chosen to recognise income when the valuation certificate was issued for a number of legitimate reasons, some of which the Tribunal had wrongly ignored. Fifthly, he argued that the Tribunal had been guilty of hindsight and of applying contemporary standards to accounts prepared some time ago. In particular, he said that there had been a shift in accounting over the last 20 years from following the legal form of transactions to emphasising the economic substance of them, and that it was a mistake to impose current thinking on accountants preparing accounts at the dates relevant to this appeal.

58. I do not accept these arguments. They amount to an attack on the Tribunal's findings of fact and evaluation in relation to the accountancy issue, but they do not demonstrate that those findings were ones that the Tribunal was not entitled to reach. Nevertheless, I will deal with each point in turn.

59. So far as the first point is concerned, it is clear from a number of passages in the Tribunal's decision that it considered that the position was governed by SSAP 2 and FRS 5 and confirmed by IAS 18. Paragraph 66 of the Tribunal's decision is based on SSAP 2 and FRS 5. Similarly, the Tribunal's first two criticisms of Mr Tidbury's evidence in paragraph 77(a) and (b) were based on SSAP 2 and FRS 5 respectively. So too, when commenting with Mr Elsworth's evidence, the Tribunal relied on FRS 5 at paragraph 88. In its conclusions on the income recognition issue, the Tribunal explicitly referred to FRS 5 at paragraphs 96 and 99 and to IAS 18 at paragraph 98. I consider that it is tolerably clear, for the reasons discussed below, that the Tribunal was also relying upon SSAP 2 in reaching these conclusions.

60. The Tribunal recorded at paragraph 69 of its decision counsel for Mr Smith's submission that, prior to the publication of FRS 5 AN G, there was a choice of available accounting policies for dealing with income recognition in a case such as the present. It reached the conclusion, however, that, as it put it in paragraphs 96 and 97, "AN G and UITF 40 addressed issues in the penumbra of the accounting practices required by FRS 5" in relation to which there was, prior to that point "scope for judgement in determining the policy to be applied"; but that, in relation to routine issues, "the requirements of the standard were clear and there was no scope for judgement". Counsel for Mr Smith criticised this conclusion, but it was supported by the evidence of Mr Mathew, which the Tribunal expressly accepted. Accordingly, it was a conclusion which the Tribunal was entitled to reach.

61. As to the second point, it is true that Mr Tidbury's approach was supported by Mr Elsworth, who expressed the opinion that prior to FRS 5 AN G there was a range of acceptable accounting methods for dealing with income recognition in a case such as the present, and that the method adopted by Mr Tidbury was within that range. As the Tribunal noted at paragraph 80 of its decision, however, Mr Elsworth's evidence was based on the prudence concept of SSAP 2; but, as I shall discuss below, it is clear that the Tribunal did not accept that the prudence concept supported Mr Tidbury's approach to income recognition. Furthermore, the Tribunal commented in paragraph 89 of its decision that, although it found Mr Elsworth's reference to IAS 18 helpful, "we did not draw the same conclusions on reading it as those drawn by him". As I have already noted, it went on in paragraph 98 to rely upon IAS 18 as supporting its conclusions in relation to income recognition. More generally, it is evident that on the key issue of whether there was scope for judgement or only one correct approach, the Tribunal preferred the evidence of Mr Mathew to that of Mr Elsworth. The Tribunal was entitled to do so.

62. Turning to the third point, it is true that, as the Tribunal recorded in paragraph 76 of its decision, Mr Tidbury's evidence was that "it was generally accepted within the accountancy profession that turnover in the construction industry should be based on valuation certificates". Furthermore, as the Tribunal

recorded in paragraph 85 of its decision, it was Mr Elsworth's evidence that "his experience in the construction industry … was that a policy of recognising income only on valuation was prevalent". That evidence was expressly accepted by the Tribunal at paragraph 87. Counsel for Mr Smith submitted that the Tribunal was not entitled to prefer Mr Mathew's evidence to that of Mr Tidbury and Mr Elsworth because, counsel asserted, Mr Mathew had no experience of the construction industry.

63. There are two answers to this submission. The first is that, as counsel for HMRC was able to demonstrate, Mr Mathew gave evidence that he had had considerable experience of the construction industry. The second and more fundamental one is that the Tribunal did not prefer Mr Mathew's evidence to that of Mr Tidbury and Mr Elsworth on this point. On the contrary, as I have just noted, it expressly accepted Mr Elsworth's evidence on the matter. But as the Tribunal recorded in paragraph 76 of its decision, it was Mr Tidbury's own evidence that "Mr Smith was unusual in that he used his own quantity surveyor to trigger his application for payment [whereas] other businesses [i.e. other businesses in the construction industry] had less good records and procedures and simply sent unquantified requests for payment". Accordingly, as the Tribunal said at paragraph 78:

> "… even if the method was used for other construction Companies, and even if its use for them was generally accepted accounting practice, we do not see why that meant that it should apply in Mr Smith's circumstances."

The Tribunal re-iterated this point in paragraph 99.

64. Counsel for Mr Smith argued that Mr Tidbury was correct, or at least not negligent, to apply the same policy in relation to all construction industry clients. I do not agree with this. The essence of the Tribunal's decision is that Mr Tidbury was wrong to apply a methodology which might have been valid for other clients to Mr Smith's accounts because Mr Smith's business was different to those of Mr Tidbury's other clients in an important respect.

65. Counsel for Mr Smith also argued that this amounted to penalising Mr Smith for having good records and procedures. As counsel for HMRC submitted, however, that is not correct. Rather, Mr Smith's good records and procedures meant that he was in a position to recognise income, and match it to expenditure, earlier than less well-organised businesses. In any event, the Tribunal's conclusion was one that it was entitled to reach.

66. As for the fourth point, it is clear from its decision that the Tribunal accepted that the method of income recognition adopted by Mr Tidbury had been deliberately chosen by him for what he believed to be good reasons. As the Tribunal correctly recognised, however, the fact that he believed it to be an acceptable method was not determinative of the issue which the Tribunal had to decide. The principal reason which Mr Tidbury gave was that it was common practice in the construction industry because the valuation certificate was the only reliable basis for recognising income. As I have just discussed, however, the Tribunal considered that this was not a good enough reason for

using the method when preparing Mr Smith's accounts, because Mr Smith's business was unusual in employing a quantity surveyor and thus having a reliable basis for its applications for payment. Counsel for Mr Smith complained that the Tribunal had not dealt with all Mr Tidbury's reasons. In my judgment the Tribunal was not obliged to comment on all his reasons, since it gave clear reasons for concluding that Mr Tidbury's approach was erroneous. Furthermore, the main omission alleged by counsel was of a matter which the Tribunal did in fact expressly deal with in its decision. This was that an advantage of the method adopted by Mr Tidbury was that it was consistent with the VAT self-billing regime. The Tribunal dealt with this point at paragraph 50:

> "The self billing procedure played a role in the correspondence between the parties, and was suggested as support for ensuring consistency between the VAT records and the accounting/income tax records. However the VAT rules and procedures appear to us to have no relevance to the determination of the issues before us because we do not accept that VAT administrative treatment influenced generally accepted accounting practice."

67. With regard to the fifth point, it is clear from the Tribunal's decision that it was careful to consider the matter by reference to the accounting standards applicable at the relevant time. Although it referred to FRS5 AN G and UITF 40, it did so because Mr Smith's team was relying on these in support of Mr Smith's case. I can see no grounds for thinking that the Tribunal judged the accounts in question by reference to contemporary standards.

FRS 5

68. Counsel for Mr Smith submitted that FRS 5, and in particular the definition of "assets" in paragraph 17, was central to the Tribunal's analysis, but that the Tribunal was not entitled to rely upon FRS 5 as justifying its conclusions for four reasons. The first was that, so he asserted, FRS 5 had not been referred to in the expert evidence or skeleton arguments before the Tribunal, and the Tribunal had "gone off on a frolic of its own" in relying upon it. The second was that FRS 5 did not apply to Mr Smith because Mr Smith was not an "entity". The third reason was that FRS 5 was concerned with balance sheet recognition of assets and liabilities, not recognition of income and expenses in the profit and loss account. The fourth reason was that FRS 5 was not relevant because it was only concerned with off-balance sheet financing.

69. So far as the first reason is concerned, it is correct that neither expert explicitly referred to FRS 5 in his report, although, as counsel for HMRC pointed out, Mr Mathew gave a definition of "assets" which mirrored that in FRS 5. But, as counsel for HMRC demonstrated, Mr Mathew discussed FRS 5 in his oral evidence in chief and was cross-examined upon it. In the absence of a transcript, it is not clear whether or not Mr Elsworth was cross-examined on FRS 5. Either way, it is clear that at least one of the experts did give evidence about FRS 5, and that the Tribunal did not go off "on a frolic of its own".

70. Turning to the second reason, counsel for Mr Smith pointed out that FRS 5 contained no definition of "entity". He submitted that "entity" did not include an individual who was a sole trader. In support of this submission he relied upon a definition of "entity" in Financial Reporting Standard 9 "Associates and Joint Ventures" ("FRS 9") which came into effect on 23 June 1998 and upon section 836A of the 1985 Act. I do not accept this submission. In the first place, as counsel for Mr Smith himself repeatedly submitted, accounting standards are not law. As such, it seems to me that the interpretation of FRS 5 was a matter for the Tribunal unless its interpretation was one that no reasonable tribunal could hold. In my view the Tribunal was entitled to interpret "entity" in FRS 5 as extending to a sole trader. Furthermore, I do not consider that it is legitimate to interpret FRS 5 by reference to a different standard dating from about four years later, let alone a statutory provision dating from about eight years later. I would add that it is far from clear to me that this submission was made to the Tribunal or that the Tribunal was referred to FRS 9.

71. With regard to the third reason, the Tribunal clearly took the view that FRS 5 was relevant to income recognition as well as asset recognition. In my judgment that was a view it was entitled to take. After all, the two are closely connected, as can be seen from SSAP 2.

72. As for the fourth reason, it is true that Appendix III to FRS 5 indicates that, as a matter of history, it arose out of concerns about off-balance sheet financing. Counsel for Mr Smith was unable to point anything in the operative provisions of FRS 5, however, which restricted its application to off-balance sheet financing. The Tribunal clearly took the view that it was applicable to the present situation. In my judgment that was a view which it was entitled to take.

SSAP 17

73. Counsel for Mr Smith submitted that the Tribunal was wrong to rely upon SSAP 17, and relied upon evidence of Mr Tidbury and Mr Elsworth that the issue of a valuation certificate would not have been an adjusting post balance sheet event within SSAP 17. As counsel for HMRC pointed out, however, what the Tribunal said in paragraph 103 of its Decision was that "the receipts of payments" were "adjusting events indicating that the applications for payment should be valued at their full amount." This was in accordance with Mr Mathew's evidence which the Tribunal recorded in paragraph 93(e) of its decision. The Tribunal did not treat the valuation certificates as adjusting events. In this regard, it should be remembered that (a) the income recognition issue only arises where the application for payment was made before 5 April but the valuation certificate was issued after 5 April, and (b) payments were made about 30 days after the application and about two weeks after the certificate. Thus the payments would have been received well before the accounts were approved.

SSAP 2

74. Counsel for Mr Smith submitted that SSAP 2 was "the dog that didn't bark", because it was fundamental to HMRC's case and to the evidence of the three accountants, yet the Tribunal had not referred to it at all in paragraphs 96-103, which undermined its conclusions in those paragraphs. During the course of argument, I asked him whether there was any available candidate for "the standard" referred to by the Tribunal in paragraph 97 other than SSAP 2, and he was not able to identify any other standard to which the Tribunal might have been referring. On re-reading the Tribunal's decision, however, it seems to me that the Tribunal was probably referring to FRS 5. Nevertheless, I do not accept the submission that the Tribunal's failure to refer to SSAP 2 in paragraphs 96-103 means that it was not entitled to reach the conclusions it reached, for the following reasons.

75. First, as noted above, the mere fact that the Tribunal's decision might have been better expressed does not justify the conclusion was it was not entitled to reach the conclusions it did.

76. Secondly, paragraph 66 of the Tribunal's decision is clearly based on both SSAP 2 and FRS 5. As counsel for Mr Smith himself submitted, it can be seen from the reading the decision as a whole that that paragraph forms the foundation for the Tribunal's reasoning in paragraphs 96-103 and 110.

77. Thirdly, as I have already noted, one of the Tribunal's criticisms of Mr Tidbury's evidence in paragraph 77(a) was explicitly based on SSAP 2. More specifically, the Tribunal criticised Mr Tidbury for failing to recognise that the prudence concept required profits to be recognised "when realised in the form of cash or other assets the ultimate realisation of which can be assessed with reasonable certainty".

78. Fourthly, the submission made by counsel for Mr Smith is contradicted by paragraph 25 of his own skeleton argument, in which he stated:

> "The income recognition question is whether income should have been recognised for accounting purposes at the time when the application for payment was made, or at the time when the valuation certificate was issued. This is in essence the question, whether the applications for payment gave rise to 'other assets' within SSAP 2 para 14(d) (as the Tribunal held) or whether (as Mr Tidbury and the Appellant's expert witness Mr Elsworth argued), only the valuation certificates gave rise to 'other assets' in this sense, because they were not self-produced but arose from transactions with third parties."

79. In my judgment, this correctly recognises that the Tribunal considered that, viewed as at the date of the application for payment, Mr Smith had an entitlement to payment for the work done under the subcontract (albeit not a debt due and owing) the ultimate realisation of which could be assessed with reasonable certainty, as required by the prudence concept, because history showed that the applications were always paid either in full or in amounts which varied by only a few percent. (As discussed above, the Tribunal also held that, even if there was not reasonable certainty at that date, the

subsequent payment was an adjusting post balance sheet event within SSAP 17.)

80. Fifthly, as I have already held, the Tribunal also relied upon FRS 5 (and IAS 18), and was entitled to do so.

81. Counsel for Mr Smith also submitted that the Tribunal should have accepted the evidence of Mr Tidbury and Mr Smith that there was no "asset" within the meaning of paragraph 14(d) of SSAP 2 until the valuation certificate was issued because there was no debt due and owing until then. As discussed above, however, the Tribunal was entitled to conclude that in the case of Mr Smith's business there was an asset the ultimate realisation of which could be assessed with reasonable certainty at the date of the application for payment. This is supported by FRS 5.

82. Finally, counsel for Mr Smith submitted that the Tribunal had attached importance to matching income and expenditure, but failed to apply the principle recognised in FRS 5 paragraph 65 and FRS 18, Appendix IV, paragraph 14 that prudence requires more confirmatory evidence about the existence of an asset or gain than about the existence of a liability or loss (the "imparity principle"). In my judgment the Tribunal was entitled to conclude that the imparity principle was not relevant to the income recognition issue since there was sufficient evidence of the asset at the date of the application for payment.

Second ground of appeal: no negligent conduct

83. Mr Smith's second ground of appeal is put in two different ways, which I will consider separately.

Excess of jurisdiction

84. The first, and more fundamental, way in which it is put is that the Tribunal exceeded its jurisdiction in finding that Mr Tidbury had been guilty of professional negligence. In support of this contention counsel for Mr Smith argued that the Tribunal only had jurisdiction to consider whether there was "negligent conduct" by a person acting on behalf of a taxpayer. It did not have jurisdiction to consider whether an accountant was guilty of professional negligence, which was a matter within the jurisdictions of the ordinary civil courts and the professional regulatory body, namely the ICAEW. The former involved consideration of public law duties, whereas the latter involved considerations of private law duties. Furthermore, it would be unfair for the Tribunal to conclude that an accountant was guilty of professional negligence given that (a) the accountant was not party to the proceedings and (b) the burden of proof before the Tribunal was reversed.

85. I do not accept this argument for the following reasons. First, it is important to be clear that the Tribunal did not actually find that Mr Tidbury was guilty of professional negligence. It found that that he was guilty of "negligent conduct" applying the standard of professional negligence to determine whether there had been a breach of duty. That is a fine distinction, but it is a distinction

nevertheless. It does not necessarily follow that a court would uphold a claim for professional negligence by Mr Smith against Mr Tidbury.

86. Secondly, sections 29 and 36 TMA 1970 explicitly require the relevant tribunal to consider whether there has been "negligent conduct" by a person acting on behalf of a taxpayer. The person who is most likely to have been acting behalf of the taxpayer in such circumstances is his accountant or tax advisor. I find it difficult to see how the Tribunal can have exceeded its jurisdiction by making a determination which the statute requires it to make.

87. Thirdly, I do not accept that the public law/private law distinction drawn by counsel for Mr Smith is a valid or helpful one. In my judgment the statute does not require the tribunal to consider whether the person in question has breached a public law duty to the Crown. As counsel for Mr Smith himself observed, a taxpayer's accountant does not owe a duty of care to the Crown. But nor does it require proof of breach of a duty of care to the taxpayer. It may be that this is why the statute refers to "negligent conduct" rather than "negligence". Furthermore, a disciplinary finding by the regulatory body would be a matter of public law.

88. Fourthly, I do not see that the fact that the person in question is not a party to the proceedings prevents the tribunal from making a finding that there has been negligent conduct on his part. There are a number of situations in which tribunals and courts can and do make findings adverse to non-parties to the proceedings, including professional persons. An obvious example is expert witnesses. Even before the recent decision of the Supreme Court in *Jones v Kaney* [2011] UKSC 13, expert witnesses were not infrequently criticised by courts although not a party to the proceedings. No doubt the tribunal should be careful to adopt a fair procedure in such circumstances, and in particular to ensure that the person in question has an adequate opportunity to answer the criticisms made of them; but that is a different matter. In the present case there is no ground of appeal of procedural unfairness to Mr Tidbury. Nor could there be, since he was given an adequate opportunity to answer the criticisms made of his conduct.

89. Fifthly, I do not accept that the burden of proof is reversed. As counsel for HMRC accepted, and as Dr A.N. Brice sitting as the Special Commissioner held in *Employee v Revenue and Customs Commissioners* [2008] STC (SCD) 688 at [56], where HMRC asserts that there has been negligent conduct by a person acting on behalf of the taxpayer, then the burden lies upon HMRC to prove that.

90. Sixthly, particularly given the composition and expertise of the Tribunal, it was in at least as good, if not a better, position to determine whether Mr Tidbury had acted negligently as an ordinary civil court.

Wrong test

91. The second way in which this ground of appeal is put is that the Tribunal applied the wrong test. Counsel for Mr Smith submitted that the standard by reference to which the Tribunal had judged Mr Tidbury's conduct was that of

a normally competent accountant and tax advisor, whereas the standard it ought to have adopted was that of the reasonable lay person. On this basis he argued that making, for example, an obvious and significant arithmetical error in the accounts would be "negligent conduct" because a reasonable lay person should be able to spot such error, but not failing to adopt the correct accounting policy.

92. I do not accept this argument. Where the person acting on behalf of the taxpayer is an accountant engaged by the taxpayer to prepare his accounts, I agree with the Tribunal that the accountant's conduct should be judged by reference to the standard of the ordinarily competent accountant.

93. Prompted by a question I asked during the course of argument, counsel for Mr Smith also advanced an alternative argument to the effect that, even if the Tribunal had articulated the correct test, it had not actually applied that test. The Tribunal articulated the test which it applied at paragraph 27 as follows:

> "It seems to us that a person who acts for another person as an accountant and tax adviser should reasonably be expected to show the normal competence associated with the proper discharge of the duties of an accountant and tax adviser. The failure to do what an ordinarily competent adviser would do is failure to do what ought to be done. … It would thus be negligent conduct .... This is not the same as saying that because a person is a qualified accountant he is to be expected to display by virtue of his training and qualification a greater standard of care; it is saying that because of the role he occupies he should reasonably be expected to display the kind of care which a person in that role would ordinarily display."

94. Although the well-known direction to the jury as to the standard of care and skill to be expected of professional persons given by McNair J in *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582 was not cited to the Tribunal, the test articulated by the Tribunal in paragraph 27 appears to me to be perfectly consistent with it, and neither counsel argued to the contrary. Counsel for Mr Smith argued, however, that when it came to decide whether Mr Tidbury's conduct was negligent, the Tribunal failed to ask itself whether the approach to income recognition which he adopted when preparing Mr Smith's accounts fell outside the range of approaches open to a competent accountant at the time.

95. I do not accept this argument either. It is true that the Tribunal did not explicitly ask itself this question. It did, however, clearly articulate the test it was going to apply in paragraph 27 and I see no reason for thinking that it did not apply that test. Furthermore, the Tribunal did explicitly conclude that the approach adopted by Mr Tidbury was not in accordance with generally accepted accounting practice at the time. Still further, as can be seen from the foregoing discussion, the essence of the Tribunal's reasoning was that, in the case of Mr Smith's business, there was only one method of income recognition which did comply with generally accepted accounting practice.

Third ground of appeal: no discovery

96. Mr Smith's third ground of appeal is that the Tribunal made no findings of fact which supported its conclusion that HMRC had discovered a tax loss in relation to the four tax years that matter, or at least in relation to the three earliest years.

97. In support of this ground, counsel for Mr Smith submitted that the Tribunal had failed to find who discovered what when in relation to which year of account. I do not accept this. The Tribunal's decision is crystal clear as to who made the discovery, namely Mr Cotton, and in relation to which years of account. The Tribunal's decision is also clear as to what Mr Cotton discovered, namely that in preparing Mr Smith's accounts Mr Tidbury had not recognised as income sums which at the year end had been the subject of an application for payment, but not a valuation certificate, thereby understating Mr Smith's revenue and profits during that year. It is true to say that the Tribunal's decision is a little imprecise at the timing of the events which led Mr Cotton to discover this, but it is clear that Mr Cotton discovered it after 14 January 2003 (when he opened the inquiry for 2000/01). It is also reasonably clear, as counsel for Mr Smith himself argued, that, at least in general terms, Mr Cotton discovered it before 21 October 2004 (when he opened the enquiry for 2001/02), although he may have discovered further details after that point.

98. This leads to the secondary way in which counsel for Mr Smith put this ground of appeal. Given that Mr Cotton knew the accounting policy Mr Tidbury had adopted by 21 October 2004 in relation to 2001/02, he asked forensically, how could Mr Cotton thereafter discover the same thing in relation to 1997/98, 1998/99 and 1999/2000?

99. As counsel for HMRC submitted, however, this submission assumes that the timing of the discovery matters for section 29(1) when the condition relied on is that specified in section 29(4). I agree with the conclusion of the First-Tier Tribunal (Tax) (John F Avery Jones CBE and John Clark) in *Hankinson v Commissioners for Her Majesty's Revenue and Customs* [2009] UKFTT 384 (TC) (unreported) at [99] that there is a distinction in this respect between section 24(4) and section 29(5). The latter includes a temporal condition, but the former does not. The time constraints on HMRC in a case such as the present come from elsewhere, namely sections 34 and 36.

100. Counsel for Mr Smith also argued that the Tribunal's decision was contrary to the "continuity" principle, which is that one may presume that a state of affairs discovered in one year continued in later years, but not that it existed in earlier years. I do not accept this. The basis for the Tribunal's finding that Mr Cotton had discovered a tax loss in the three earlier years was that Mr Tidbury had told Mr Cotton that he had prepared the accounts for those years in the same manner as he had used for the 2000/01 accounts. The Tribunal did not presume this.

Conclusion

101. The appeal is dismissed.

Mr Justice Arnold

Release date: 10 May 2011