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RUDGE REVENUE REVIEW

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SECTION I

"REVIEWS: FIGLEAF OR SHIELD?"

INTRODUCTION

The Tribunals, Courts and Enforcement Act 2007 introduced a comprehensive new regime for direct and indirect taxation appeals as part of a newly harmonised Tribunal system. That appeal system includes a statutory right for the appellant taxpayer to have the decision (the "Decision") of HMRC which is the subject of his appeal, reviewed by HMRC.[1] This article deals with the provisions of the Taxes Management Act 1970 sections 49A-49I as they relate to a taxpayer who requests a review under those sections.[2] It does not consider, for example, the similar provisions which apply for Inheritance Tax[3] or Stamp Duty Land Tax.[4]

HMRC'S STATISTICS

HMRC have published statistics of the results of the first year of the Review Process.[5] They make startling reading. No less than 44.9% of the completed reviews cancelled the Decision concerned in its entirety. In a further 5.2% of completed reviews the Decision was varied. It appears, therefore, on the basis of HMRC's own statistics, that where the Revenue have raised an assessment which is appealed by the taxpayer concerned and a review is conducted, they are wrong in more than half of cases. If one looks only at those cases which do not involve penalties, the decision was either cancelled or varied in 39.3% of them. One doesn't know whether to be appalled that so many incorrect assessments are raised or pleased that the review process has managed to prevent such a large number of unnecessary hearings.

HMRC'S UNSATISFACTORY APPROACH

One might think therefore, that the Review Process has proved to be a success but it is clear from our own experience and from the comments of others, that the process is not being applied correctly by HMRC and, in technically more complex cases, that it is regarded by them as a mere exercise in rubber-stamping. That may be because HMRC do not seem to recognise the significance of the change from the purely internal and discretionary procedures which preceded the Review Process to the Review Process itself which is a process governed by statute.

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1 The process as a whole is referred to in this article as the "Review Process"
2 All references in this article are to the Taxes Management Act 1970 unless otherwise stated
3 IHTA 1984 sections 223A-223I
4 FA 2003 Sch 10 paras 36A-36I
5 "HMRC's Review Process – the first 12 months". The paper deals with all reviews and not just reviews conducted under the Taxes Management Act 1970

For example, in the first statistical review released by HMRC,[6] they explained:

> "On 1 April 2009 HM Revenue & Customs (HMRC) introduced a new optional, internal review process."

It is Parliament that passes legislation, however, and not HMRC.

In their Manual they refer to a customer appealing to HMRC[7] but HMRC are neither a Tribunal nor a Court and appeals cannot be made to them. Appeals to which the Review Process applies are any appeals under the Taxes Act. Such appeals are appeals from the Decisions of HMRC to the First-tier Tax Tribunal or, in some circumstances, to the Upper Tribunal. HMRC have not yet become judge in their own cause. Perhaps HMRC are confused because notice of an appeal to the Tribunal is first given to HMRC and, as we shall see, if the Review Process is activated, notice to the Tribunal is suspended until it has been completed.

A POTENTIALLY USEFUL PROCESS

The Review Process is a statutory process which imposes various duties on HMRC. Where a statutory body, such as HMRC, does not comply with that statutory duty the law, through judicial review, will provide a remedy.

If HMRC is persuaded or forced to apply the process properly, it can be of great benefit to a taxpayer. First, a reconsideration of the issues by a person genuinely independent of the original decision maker can and should lead to many assessments being withdrawn before they reach a Tribunal. Even where that is not the result, the process can be useful. HMRC often refuse to give the grounds of their conclusions in raising Closure Notices or Discovery Assessments or give only the sketchiest view of their reasoning. The Review Process ought to give the appellant taxpayer a much better idea of the grounds of HMRC's Opinion and of its strengths and weaknesses before he goes to the considerable expense and inconvenience of notifying his appeal to the Tribunal. Undertaking the review procedure will force HMRC to consider their own position and to undertake quite a large amount of work. That will encourage them to identify where they have a weak case and to settle the matter before they are forced to undertake the onerous work of a review.

It is, therefore, important that the appellant taxpayer should insist that the review is conducted strictly in accordance with its statutory framework and it is to be hoped that, where it is not and HMRC refuse to remedy their failure, appellant taxpayers will seek judicial review.

A PURPOSIVE CONSTRUCTION

As we shall see, HMRC are given a wide discretion to determine the nature and extent of the review but, as the case of *BMBF v Mawson*[8] made plain, all legislation must be construed in

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6 "HMRC's Review Process – Nine Month's On"

7 Appeals, Reviews and Tribunals Manual para 4030

8 *Barclays Mercantile Business Finance Limited v Mawson (Inspector of Taxes)* HL 2004 [2005] STC 1

the light of Parliament's purpose in enacting that legislation. The function of a purposive construction of a statute is to ascertain, not what Parliament meant, but the true meaning of what Parliament said.[9]

Although in certain circumstances the determination of Parliament's purpose may be aided by reference to external materials, it is primarily to be determined from the legislation itself[10] by a consideration of its form and of its place in the wider context of the legislation of which it forms part.[11] HMRC's discretion to determine the nature and extent of the review, therefore, must be exercised so as to fulfil the statutory purpose of the Review Process and that purpose is primarily to be determined from the statutory provisions which govern it although external materials may be referred to where the purpose is not apparent from the words of the legislation itself.

Where a taxpayer appeals against any of the forms of assessment listed in s.31 including against a Closure Notice under s.28A or a Discovery Assessment under s.29, the appeal must be lodged within 30 days[12] and must specify the grounds of the appeal.[13] HMRC or, on appeal, the Tribunal may allow the hearing of an appeal made after the expiry of this time limit.[14]

The Notice of Appeal must be given to "the relevant officer of the Board" – that is to the officer by whom the Notice of Assessment was given.[15]

As we shall see, the legislation contains very exact provisions providing for information to be supplied to the appellant taxpayer by HMRC and for the appellant taxpayer to make representations to the Reviewing Officer. Those provisions are clearly designed to allow an even-handed review to be made of the Decision before the matter is brought before the Tribunal. Because that review is at the option of the taxpayer it is reasonable to assume from the form of the provisions that the purpose of the Review Process is to provide a review of the Decision which is independent of the decision maker so that HMRC can identify if the Decision is incorrect and avoid wasting the time and money of the taxpayer in an unnecessary appeal.

This view of the purpose of the provisions gained from a consideration of their form is supported by external materials.

Section 49A – 49I were inserted into the Taxes Management Act by the Transfer of Tribunal Functions and Revenue and Customs Appeals Order[16] with effect from 1st April 2009. When the Order was published in draft, an explanatory memorandum (the "Explanatory

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9 *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg,* AG [1975] AC 591 at [613]

10 Bennion Statutory Interpretation Part XVIII p.289. See *Aston Cantlow and Wilmcote with Billeley Parochial Church Council v Wallbank* [2004] 1 AC 546 at [37]

11 See Simon's Taxes para A2.118

12 Section 31A (1)

13 Section 31A (5)

14 Section 49

15 Section 31A (2)

16 Transfer of Tribunal Functions and Revenue and Customs Appeals Order, S1 2009/56 Art 3, Sch 1 paras 5 and 30.

Memorandum") was issued which explained the "policy background" to the tribunal reform and of the introduction of the Review Process as part of that reform. That document explained:

> "The adoption of a common policy on review across HMRC's tax business is intended to provide clearer safeguards for taxpayers who dispute HMRC decisions and to help ensure that the tribunal is not burdened by cases which could have been resolved by review. Important benefits include:
>
> - making HMRC action in reviewing decisions more transparent for taxpayers;
> - helping assure quality and consistency in HMRC decision making;
> - helping ensure that as many disputes as possible are resolved informally, without the expense or anxiety of a hearing;
> - helping to achieve the HMRC aspiration to improve communication and to be more open in its dealing with taxpayers."[17]

It can be seen that the Explanatory Memorandum distinguishes between the intention of the adoption of the review and the benefits which are expected to flow from it. The intention is:

(a) to provide clearer safeguards for the taxpayer.[18]
(b) to help ensure the Tribunal is not burdened by cases which could have been resolved by review.

The purpose of the legislation is not, therefore, primarily to benefit HMRC but rather to safeguard the taxpayer and to avoid wasting the Tribunal's time. The benefits for HMRC which are listed in the bullet points are incidental to those purposes. It is clear that if the Review Process is to safeguard the client and to save the Tribunal from wasting its time, it must be concerned with whether or not the Decision is correct and not, for example, with whether it is in accordance with Revenue practice or internal departmental procedures.

THE PROVISIONS IN DETAIL

Section 49A

Section 49A provides the appellant taxpayer with the right to a review. It provides that where a notice of an appeal has been given to HMRC, the appellant may notify HMRC that he requires HMRC to review the matter unless it has already been notified to the Tribunal or a review is already either in progress or has taken place.[19]

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[17] Explanatory Memorandum of the Draft Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 para 7.2.5

[18] That the purpose of the process is to safeguard the taxpayer appellant was emphasised throughout the consultations which took place on these provisions. See for example "Modernising Powers, Deterrents and Safeguards: Safeguards for Taxpayers Consultation Document 17 May 2007" paras 1.1 and 1.4 and "Tax Appeals against decisions made by HMRC: Technical Document June 2008" paras 1.1 and 1.5

[19] Section 49B(4)

Notice of HMRC's Views under Section 49B(2)

Once an appellant has notified HMRC that he requires a review, HMRC must, within the relevant period, notify the appellant of HMRC's views.[20] The relevant period is the period of thirty days beginning with the day on which HMRC receives the notification from the appellant taxpayer or such longer period as is reasonable.[21] One might think that if HMRC have issued an amendment under a Closure Notice or Discovery Assessment they must know why they have reached the conclusion that the amendment or assessment is necessary and, therefore, ought to be able to state their view of the matter within a matter of days rather than a month. It is difficult, therefore, to envisage any circumstances in which a longer period would be reasonable.

In respect of Section 49B(2), the Explanatory Memorandum refers to the situation where negotiation and discussion have taken place since the original appeal notification. Where the review is requested by the taxpayer, however, he will normally do so at the time of his appeal and the function of s.49B(2) is clearly more important than simply dealing with the rare situations where additional information has become available after the appeal. Unless HMRC's reasoning in arriving at its conclusion is set out it is difficult to see how the Review Officer can determine whether the Decision is correct or how the appellant taxpayer could have an adequate opportunity to put his own arguments before the Review Officer as he has a right to do under s.49E(4). Where a Closure Notice is issued, the Notice only has to state the Officer's conclusions and not the grounds of those conclusions.[22] Similarly, a Discovery Assessment simply has to state the additional amount of income or gains which are to be charged to tax.[23] It is clear that stating HMRC's view of the matter must involve much more than this and that, in the light of the statutory purpose of the legislation, must involve a statement of the reasoning leading to the Decision.

In practice, in notifications under s.49B(2), HMRC often merely repeat the wording of the Decision or, sometimes, merely refer to the Decision notice as containing their view of the matter. Where HMRC do so, it is clear that they have not complied with s.49B(2). We have even had experience of HMRC not issuing a notice or purported notice under s.49B(2) at all because the officer concerned had thought that that sub-section referred to the conclusions of the review itself! As we shall see, whether or not a valid notice under s.49B(2) has been given is crucial to determining the time limits which apply to the later parts of the Review Process.

What are the consequences if HMRC do not issue a notice under s.49B(2) within the relevant period? The legislation does not provide any specific sanction. As we shall see, however, further key periods are defined by reference to the 'relevant day' which is the day when HMRC notifies the appellant of HMRC's view of the matter in question. Thus if no notification of HMRC's view is made, the appeal is put into a sort of stasis. The appellant taxpayer's only means of enforcing HMRC's exercise of its duty is by making an application for judicial review. Of course, it may be that he will be happy for the whole matter to be suspended.

[20] Section 49B(2)
[21] Section 49B(5)
[22] Section 28A(1)
[23] Section 29(1)

The Conduct of the Review

According to HMRC's published guidance, once the Review Process has commenced, the Review Officer should write to the appellant taxpayer (referred to in the guidance as the "customer") informing him:

(a) that he will be undertaking the review;
(b) of his contact details;
(c) of when he expects to complete the review, seeking agreement to a new time limit if appropriate;
(d) of what will happen if he does not complete the review by the time limit; and
(e) asking the 'customer' to send to him any further information or arguments that the 'customer' wants him to consider.[24]

Independence of the Reviewer

It is clear that if the review is to achieve its statutory purpose, the reviewer must be independent of the decision maker.[25] In fact, this requirement is often breached. We have heard of cases in which the decision maker himself has been appointed to review the matter although we do not have experience of that ourselves. What we have experienced are situations where substantially the same point is relevant to a group of taxpayers, in particular where they have undertaken tax planning transactions to a common pattern, and an inspector raising assessments on one taxpayer within the group has been appointed to review a Decision in respect of another taxpayer within that group. In such a case, it is clear that the Review Officer cannot conduct the review with the independence which is necessary to achieve the purpose of the provisions and it is therefore arguable that his purported review is not a review for the purpose of the provisions at all. Similarly, we have seen situations where a review has been conducted and the Decision upheld where the review was invalid, because, for example, no Notice had been issued under s.49B(2), and the same individual who has conducted the invalid review has then been reappointed to conduct a correct review. It is difficult to see how such an individual can have the required independence of the Decision if he has already purported, invalidly, to uphold it.

Reviewing HMRC's policy and procedure

As we have seen, HMRC have a wide discretion as to the nature and extent of the review, but that discretion must be such as to fulfil the Review Process' statutory purpose. The Revenue guidance says that:

> "The Review Officer does not have discretion to go outside current policy and practice."[26]

[24] Appeals, Reviews and Tribunals Manual para 4610
[25] The consultation on the review process emphasised the importance of the Review Officer being independent of the decision maker. See "Tax Appeals against decisions made by HMRC: Consultation Document October 2007" para 1.3, "Tax Appeals against decisions made by HMRC: Summary of Responses and Future Direction March 2008" paras 2.5, 3.4, 3.12 & 3.13
[26] Appeals, Reviews and Tribunals Manual para 4080

If, however, current policy or practice has led to an incorrect Decision, a refusal to consider the correctness of that policy or practice will lead to the frustration of the purpose of the review. If the very matter in dispute is the subject of the policy or practice then it is clear that the Review Officer has a duty to consider its correctness. If HMRC's internal procedures prevent him from doing so, HMRC have a duty to change their procedures.

Use of Revenue Specialists

The duty under the statute for HMRC to conduct a review is an absolute one. It is not qualified by, for example, the resources which are available to HMRC.[27] It is HMRC's duty to employ sufficient, and sufficiently competent, staff to conduct the review. The Review Officer may take advice even if that advice comes from an HMRC specialist. If the purpose of the legislation is to be achieved, however, that advice must itself be independent of the Decision and the Review Officer must be at least capable of considering its correctness. He cannot simply accept it without turning his mind to the question of whether the person consulted has the necessary expertise and whether he has properly addressed the questions which have been put to him.

In practice, it appears that Review Officers simply defer to HMRC specialists without making any independent assessment of the specialist advice. Often, the specialist concerned is the very specialist on whose advice the Decision maker has relied in reaching his Decision. It is clear that in such circumstances the Review Officer is not conducting an independent review of the correctness of the Decision.

Representations under Section 49E(4)

Section 49E(4) provides that:

> "The review must take account of any representations made by the appellant at a stage which gives HMRC a reasonable opportunity to consider them."

The Reviewing Officer must allow sufficient time

It is plainly necessary for the appellant taxpayer to be given an opportunity to consider the matters set out in the notification under s.49B(2) particularly if he has not previously been given a full account of HMRC's reasoning. If he is to do this he must be given a reasonable amount of time to do so after the notification under s.49B(2) and, of course, the Review Officer must take sufficient time to consider the points which are made to him. The Review Officer must therefore allow time for the appellant taxpayer to consider the notification under s.49B(2) and to make representations under s.49E(4) and for the Review Officer to consider those representations.

In practice, HMRC often seem to regard the requirement of s.49E(4) for the Review Officer to consider the appellant taxpayer's representations to be a matter of mere form. In one case we dealt with, the Review Officer's letter requesting information from the appellant taxpayer arrived on the day on which he issued his conclusions.

[27] Section 49B(3)

The Conclusion of a Review

The Review Officer's conclusions must be notified to the appellant taxpayer within a specified time period which begins with the relevant day, that is with the day on which a notification under s.49B(2) is issued.[28] So if no such notification is issued, no Notice of the conclusions of the review may be given. The period is 45 days beginning with the relevant day or such other period as may be agreed.[29]

If HMRC do not issue their conclusions within this period the review is deemed to have been concluded and HMRC's view of the matter to have been upheld.[30] HMRC must notify the appellant of the conclusion which the review is treated as having reached.[31]

The provisions of Section 49E(8) deeming a review to have been concluded will not apply to the situation where no notice has been issued under s.49B(2). As we have seen, the period in which the Review Officer must give notice of the conclusions of his review only begins when that notice is issued, so until it has been issued it will not be possible to say that HMRC has not issued its conclusion within the time period provided.

The review may conclude that HMRC's view of the matter in question is to be upheld, varied or cancelled.[32]

Notification to the Tribunal after a Review is concluded

Where a review has been concluded the conclusions are treated as if they were an agreement in writing between HMRC and the appellant taxpayer under s.54(1).[33] This does not apply, however, if the appellant notifies the appeal to the Tribunal under s.49G.[34] Under s.49G the appellant may notify the appeal to the Tribunal within the post-review period or, if that period has ended, he may do so if the Tribunal gives permission.[35] Where there has been an actual conclusion of the Review Process, the post-review period is the period of 30 days beginning with the date of the document in which HMRC gave notice of the conclusions of the review. Where HMRC have not issued a conclusion but are deemed to have done so because the review period has ended, the 30 day period runs from the end of the review period until 30 days after the date on which HMRC gave notice of the deemed conclusions of the review under s.49E(9).[36]

This is some protection against the taxpayer overlooking the fact that the review period has passed without HMRC having issued a notice of their conclusions of the review.

Section 49G only applies where there has been a conclusion, or a deemed conclusion, to the review. Where there has not because no notice under s.49B(2) has been issued, having

[28] Section 49E(6) and (7)
[29] Section 49E(6)
[30] Section 49E(8)
[31] Section 49E(9)
[32] Section 49E(5)
[33] Section 49F(2)
[34] Section 49F(4)
[35] Section 49G(2) & (5)
[36] Section 49G(5)

requested a review the appellant taxpayer cannot notify the appeal to the Tribunal. As we have said, the appellant taxpayer's only remedy is to apply for an order, under judicial review, that HMRC should give the notice required by s.49B(2).

CONCLUSION

The right of a taxpayer to require HMRC to review a Decision, construed purposively, is an important one which gives substantial protection to the taxpayer and imposes onerous duties on HMRC. It is clear that HMRC do not give proper weight to those duties and that their practice fails to comply with them in a number of important respects. An appellant taxpayer should be prepared to insist that the procedure is followed properly and be prepared to enforce it with judicial review proceedings, in appropriate circumstances, if necessary.

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SECTION II

"SEPARATING THE SHEEP FROM THE GOATS

A CHANGED CLIMATE"

INTRODUCTION

Avoiding tax is unpopular at the moment. The unfortunate staff of Vodafone, Top Shop, HSBC, Barclays, Santander, RBS and even Boots and Fortnum & Mason have seen their stores targeted by demonstrators, sometimes violently, confident of their ability to understand the complexities of corporate taxation. HMRC have been strident in their condemnation of legal tax avoidance deliberately eliding the distinction between such avoidance and criminal tax evasion. The Government feels called upon to "consult" on a General Anti-Avoidance Rule although it seems unable to distinguish between avoidance and evasion having provided an extra £900m to combat one or the other – it doesn't seem clear as to which.

The Courts are not uninfluenced by fashions in public opinion and in recent years they have shown themselves determined to find against tax planning schemes regardless of the violence which they must do to the statutory language to do so. When many of those schemes were implemented in the early years of the millennium, however, there was a very different climate for tax avoidance and the schemes often seemed to have good prospects of success. Pre-packaged schemes were eagerly marketed, not only by their creators and imitators, but also by a host of intermediaries including many of the leading firms of solicitors and accountants as well as a number of the large banks. Now that many of those schemes have failed, it is natural that the taxpayers concerned will wish to consider whether they can recover their losses from those who advised them to implement the schemes. Those advising such clients, will wish to know whether they might themselves be the target of such claims and whether their clients have viable claims against their other advisers.

QUANTUM OF DAMAGE

Of course a successful claimant will not be able to recover the tax which he hoped to save under the scheme for this will normally be a cost he would have borne even if correct advice had been given. Sometimes, participation in a scheme which has failed may actually have increased the participant's tax liability and this would certainly form an element of the damages sought by a claimant. A claimant will hope to recover his transaction costs, the fees he has paid for the advice, any tax penalties he has suffered and, also, a sum in respect of interest on late payment of tax. Any such interest element however, would take account of the fact that the claimant had had the use of the money he would otherwise have paid in tax at an earlier date. It would also take account of whether he had mitigated his loss by buying a certificate of tax deposit, or making a payment on account, when it became apparent that the scheme was likely to fail. Damage arising from the client's loss of the opportunity to reduce his tax liability through other means poses difficult problems of evidence and quantification but may also form a part of some claims.

POTENTIAL DEFENDANTS

The potential targets of such claims will include the promoters of the scheme, those who introduced the client to the promoters, the client's general tax advisers who may have provided advice or a second opinion in respect of the scheme and any Counsel whose opinion was used to promote the scheme. The claim is most likely to be under the Law of Contract or of the Tort of Negligence.

THE SCOPE OF THE ENGAGEMENT

Advice on Implementing the Scheme

In respect of possible contractual claims, the place to start is to determine the scope of the relevant engagement contract. Promoters may well have carefully defined the services which they were to provide and the degree of reliance which the client could put on their advice. Where the advice was given as part of a continuing relationship, however, it is not uncommon to find that the express terms of the engagement are highly general and their application to the advice actually given very uncertain. One needs to consider any limitation of liability clause the contract may contain and the extent to which a failure by the adviser to direct the client's attention to it makes it unenforceable. It is of course common in tax planning strategies for advisers to receive remuneration in the form of commission particularly if they are acting primarily as introducers. Where that is the case, one might consider whether that commission was properly disclosed to the client in accordance with the rules of the relevant professional bodies. Where the tax planning transactions included a financial instrument, one needs to consider whether and to what extent financial services legislation applied to the arrangements.

WAS THE ADVICE OF THE REQUIRED STANDARD?

Advice on the Scheme and its implementation

In an engagement to provide professional advice it will normally be an implied term of the engagement that the advice will meet the standard of competence of the ordinarily competent professional adviser holding himself out as able to provide advice in the area concerned. The advice will not be in breach of that term simply because the scheme has failed. The question is, would the advice have been given by such a reasonably competent professional adviser who was in the position that the actual adviser was in at the time that the advice was actually given?

To answer that question one would need to consider whether the advice took proper account of the relevant statute and case law at the time and of the known practice of HMRC (or its predecessor bodies). Did it properly take account of the probability that HMRC would challenge the view of the tax consequences of the transactions taken by the adviser and did it make a reasonable assessment of whether the expected view of HMRC would be upheld by the courts? Did the advice properly communicate that assessment of probability to the client?

Did the advice reasonably quantify the risk of loss if the scheme failed? Did it identify the direct costs which would be born by a client in dealing with an enquiry and of appealing to the

Special Commissioners or later, the First-tier Tax Tribunal and from there to the Courts. Did the adviser properly explain the taxpayer's rights of appeal both to the Tribunal and to the High Court? Did it deal with the risk of interest being charged on the late payment of tax and of a penalty being imposed? We have seen advice which simply provided an explanation of how the relevant statutory provisions were expected to apply to the transactions without giving any indication that there is in all tax planning of this sort an inherent uncertainty of outcome.

If, at the time the strategy was implemented, there was some actual experience of HMRC's response to returns of transactions taking place under the strategy, did the advice properly summarise that experience? For example, we have known advisers to refer to the submission of a tax return and the failure of HMRC to raise an enquiry into that tax return as the scheme having been 'accepted' by HMRC. Of course, it is nothing of the sort.

Advice and Disclosure

Where the scope of the engagement included providing advice on the disclosure to be made of the scheme in the taxpayers' tax return, did the advice take proper account of the need to provide protection against the imposition of penalties and the issue of a discovery assessment? The law of discovery has developed significantly since the period when most such schemes were implemented and so the fact that HMRC have successfully raised a discovery assessment is not of itself proof that the advice on disclosure was in breach of the adviser's duties under the engagement.

Advice on a Subsequent Enquiry and Appeal

Where the advice included continuing advice on dealing with HMRC in respect of the scheme and on the conduct of litigation, did it take proper account of developing case law and revenue practice? As litigation proceeded, perhaps through several levels of appeal, did the adviser adjust his assessment of the probability of success in the light of experience? It is common in such tax strategies to have an element of remuneration which is contingent on the outcome of the strategy. Did the advice on the conduct of the enquiry and litigation have proper regard only to the interests of the client and not to the interests of the adviser?

It was common for promoters of schemes to protect their intellectual property by revealing them to potential clients and introducers only on conditions of confidence set out in a confidentiality agreement. That was entirely proper. Usually those agreements will now have no further function because the techniques which they sought to protect will have been disabled by later legislation or become generally known. When an adviser is anxious that his conduct might be subject to criticism he may be tempted to use such agreements to prevent the client from obtaining a second opinion or alternative advice. Apart from the fact that the attempt would almost certainly be unsuccessful, there will be a clear conflict of interest in continuing to provide advice in these circumstances.

COUNSEL'S OPINION

Most designers of tax planning strategies will have taken a detailed opinion from Counsel on them. Normally that will have had a dual purpose. First, it provided additional assurance to the designer that his strategy was robust and likely to be successful by its being reviewed by an independent and objective expert. Secondly, it provided comfort to potential clients that the strategy had been reviewed by an expert who did not have a financial interest in the client implementing it. The adviser's reliance on the Counsel's opinion may provide a substantial defence to a claim that he has been negligent. But that may be dependent upon whether the Counsel had the requisite expertise in the areas of law relevant to the strategy. In particular, if the strategy fails on an issue which is not a matter of revenue law, such as contract law, insurance law or land law, if the Counsel was an expert in Revenue law did he also have the requisite expertise in that other area of law? Often an additional opinion will have been obtained from Counsel expert in another area of law. In that case, one needs to examine whether the instructions and Counsel's Opinion properly dealt with those aspects of the matter which were relevant to the tax issues at stake.

In respect of all relevant opinions, whether they be just on matters of Revenue Law or on other areas of law as well, one needs to consider whether the instructions were properly drafted so that Counsel's Opinion was actually obtained on all of the issues relevant to the success of the strategy. Perhaps the very issue on which the strategy failed was one which was excluded from Counsel's consideration by the Instructions. Were the facts set out in the Instructions an accurate and complete account of the relevant facts? Some years ago we saw a set of instructions in relation to the application of the transfer of assets abroad legislation which stated as a fact that all of the transactions were genuine commercial transactions which were not designed for the purpose of avoiding liability to taxation. It was hardly surprising that Counsel was able to say, on the basis of the instructions, that the transfer of assets abroad rules did not apply.

If one concludes that the instructions were inadequate what responsibility did the adviser have in respect of those instructions? How was Counsel's Opinion used in persuading the taxpayer to enter into the scheme? What reliance did the taxpayer place on it? Is there a potential claim against Counsel?

FIGHTING FUNDS

In many strategies a Fighting Fund was established to meet the costs of establishing the success of a scheme. Was advice provided in respect of those arrangements? If so, did it properly assess the adequacy of the Fund and of the arrangements for its operation?

THE NEED FOR AN EXPERT

There have always been cycles of tolerance and intolerance by the Government, the Revenue authorities, the Courts and the general population of tax avoidance planning. The fact that we are in a phase of extreme intolerance in the current cycle does not mean that advice given in an earlier phase was incorrect or negligent. Many advisers were highly responsible in the advice they gave on such schemes and were scrupulous in their presentation of the risks and rewards of tax planning schemes and of their possible outcomes to the client.

Advising on Managing Enquiries and Subsequent Litigation

That was not, however, always the case. Having ourselves designed and implemented marketed tax planning schemes in the past, we now find ourself advising in respect of the management of HMRC's enquiries into schemes implemented on the advice of others and on the resulting litigation. Our experience suggests that there were a number of promoters of, and advisers on, such schemes whose advice fell below acceptable professional standards.

The Role of the Expert in Litigation

So, some taxpayers who implemented such schemes in good faith will be contemplating litigation against their advisers. Many of the questions involved will concern what a reasonable adviser would have done and advised at the time concerned. The consideration of that issue will require the input of an expert to assess the advice and actions of the adviser so as to allow the litigating solicitor to assess the validity of a claim and, in due course, for the expert, if it is appropriate, to give evidence in the proceedings.

Responsible advisers will not be immune from claims but such claims are likely to be unsuccessful. Less responsible advisers will find themselves having some rather uncomfortable conversations with their professional indemnity insurers.

Simon McKie is an Expert Witness listed on Legal Hub [www.legalhub.co.uk]

SECTION III

"INSURANCE VALUATIONS"

INTRODUCTION

Insurance policies are an invaluable tool in inheritance tax planning. For that very reason, a certain amount of anti-avoidance legislation has grown up to restrict their advantages including the valuation provisions of s.167.[37] *This article considers s.167 and explores some of its quirks.*

TWO COMMON FORMS OF POLICY

In most common forms of life insurance policies, a person entering into a policy pays a premium or premia in return for the right to be paid benefits on maturity and, often, on surrender. The maturity of the policy will be dependent to some extent upon the continuance or cessation of a life or lives assured. By way of illustration of the valuation principles examined in this article we shall look at a conventional single premium investment bond and a single, whole of life, regular premium policy providing a level sum assured.

Single premium investment bonds

Investment bonds mimic the economic features of collective investments whilst, because they are policies of life insurance, receiving the tax treatment which applies to such policies.

A typical investment bond will be written on one or more lives including the life of the person to whom the policy is issued and will provide for the payment of a surrender value on the surrender of the policy in whole or in part at any time and a maturity value on the death of the, or of the last of, the lives assured. The surrender value, at any time, will be determined by the value of a group of assets of the insurance company accounted for in 'units' into which the premium is notionally 'invested'. It would be normal for the bond to provide for an initial premium to be paid and, at the option of the policy holder, for further premia to be paid. Often, the insurance company will apply the premium received first to a 'charge' and make a notional investment of only the net amount in units. Further annual 'charges' are then 'met' by 'encashing' small numbers of 'units'. It is important to understand that the whole mechanism of 'units', 'charges' and 'encashments' is simply a way of calculating the benefits payable under the policy. It is merely a hypothetical or fantasy world.[38] The assets notionally divided into 'units' remain at all times the property of the insurance company and the contract between the insurance company and the policy holder is simply a contract for the payment of benefits calculated in accordance with the unit mechanism in return for the policyholder's payment of premia.

[37] All references in this article to the Inheritance Tax Act 1984 unless otherwise stated

[38] It is for this reason that we have placed inverted commas on words referring to this notional investment

Single, whole of life, regular premium policy

Under a single, whole of life, regular premium policy for a level sum assured the policyholder pays premia at regular intervals of a year or less of a level amount in return for the company's undertaking to pay a fixed sum on the death of the life assured. Such policies are commonly used to create funds outside a taxpayer's estate which will not themselves bear inheritance tax on the taxpayer's death and will be available to his heirs to meet the inheritance tax arising on his death.

THE RELEVANT STATUTORY PROVISIONS

Section 160

The general method of valuing property for the purposes of inheritance tax is provided by s.160:-

> "Except as otherwise provided by this Act, the value at any time of any property shall for the purposes of this Act be the price which the property might reasonably be expected to fetch if sold in the open market at that time; but that price shall not be assumed to be reduced on the ground that the whole property is to be placed on the market at one and the same time."

Section 167

In respect of certain life insurance and annuity policies this general rule is supplemented by the specific provisions of s.167:-

"(1) In determining in connection with a transfer of value the value of a policy of insurance on a person's life or of a contract for an annuity payable on a person's death, that value shall be taken to be not less than-

(a) the total of the premiums or other consideration which, at any time before the transfer of value, has been paid under the policy or contract or any policy or contract for which it was directly or indirectly substituted, less

(b) any sum which, at any time before the transfer of value, has been paid under, or in consideration for the surrender of any right conferred by, the policy or contract or a policy or contract for which it was directly or indirectly substituted.

(2) Subsection (1) above shall not apply in the case of -

(a) the transfer of value which a person makes on his death, or

(b) any other transfer of value which does not result in the policy or contract ceasing to be part of the transferor's estate …

……………………

(5) References in subsections (1) … above to a transfer of value shall be construed as including references to an event on which there is a charge to tax under Chapter III of Part III of this Act (apart from section 79), other than an event on which tax is chargeable in respect of the policy or contract by reason only that its value (apart from this section) is reduced."[39]

APPLYING SECTIONS 160 AND 167

It can be seen from sub-section 2 that the special valuation rules of s.167 will only apply to a transfer of value otherwise than on death which results in the policy or contract ceasing to be part of the transferor's estate. Where they apply, they ensure that the amount of the transfer of value will not be less than the premia which have been paid under the policy and certain other payments in respect of the surrender of rights under the policy.

Investment bonds

Entering into the policy

When a person enters into a policy, he will make a disposition. That disposition will be a transfer of value if it results in the value of his estate immediately after the disposition being less than it would be but for the disposition.[40] If the disposition is a transfer of value it will be a chargeable transfer unless it is an exempt transfer.[41] The disposition will certainly not be a potentially exempt transfer because the value transferred will not be attributable to property which by virtue of the transfer becomes comprised in the estate of another individual nor will it increase the estate of another individual.[42] If, therefore, the policy on inception has a value which is less than the diminution in the policyholder's estate by reason of the consideration to be given by the policyholder under the policy, there will be a chargeable transfer.[43]

In what circumstances will all these conditions be satisfied? One might argue that many insurance policies are worth less immediately after they are issued than the initial premium paid for them. For example, as we have seen, it is common in investment bonds for initial charges to be made before the notional 'allocation' of 'units' and for the 'units' to have a 'bid/offer spread' under which the 'price' at which they are 'allocated' in satisfaction of the premium will be higher than the 'price' at which they are 'redeemed' in satisfaction of policy benefits. The result is that if one takes out an investment bond and surrenders it immediately afterwards, the surrender value of the bond is likely to be less than the amount of the premium paid under the policy. One might argue, therefore, that the market value of the policy will similarly be less than the amount for which it was acquired.

That, however, is surely an incorrect view of the matter. There is a large and competitive market in investment bonds. A large number of customers of the insurance companies take out such bonds on the basis that the company's charges, including the initial charges built into

[39] Sub-section 3, which excludes from these provisions certain term policies and sub-section 4 concerning certain regular premium unitised policies are omitted
[40] Section 3(1)
[41] Section 2(1)
[42] Section 3A(2)(b)
[43] Subject to s.10 which is discussed below

the structure of the policy, are worth bearing in order to have the advantages conferred by the policy. Those are the benefits of the policy structure, the financial strength of the insurance company, the administration of the policy and the management of the investments to which the policy benefits are linked. So the mere fact that the surrender value of the policy immediately after it comes into effect is less than the premium paid in respect of it does not mean that its market value will necessarily be less than the premium paid.

Of course there will be situations in which the original policyholder has made a bad bargain. For example, insurance companies offer commission to financial advisers on their products. Those advisers will often forego that commission by agreement with their clients so that a larger amount of the premium is 'allocated' to 'units' but, often, only when their clients request them to do so. A naïve client who does not do so, will have made a chargeable transfer.[44] Such chargeable transfers are not likely to be very large but if, for example, a policyholder allows his financial adviser to take 2% more commission than is the market norm on an investment policy with an initial premium of £2m, he might, subject to s.10, make a transfer of value of £40,000 (£2m x @ 2%).

Possibly more significant, are situations where, for tax planning purposes, terms are added to otherwise standard policies which are of advantage to the issuing company with no corresponding adjustment to the premia payable on the policy. For example, after the trust 'reforms'[45] of 2006, it has been necessary to find new ways of making gifts to benefit young adults without giving absolute control of substantial assets to them. A solution offered by one insurance company is to create a policy (a "No Surrender Value Policy") which cannot be surrendered during the life of the life assured. The policy is simply the company's standard investment bond shorn of its surrender rights. The company does not offer enhanced terms to reflect the fact that the funds are not subject to immediate withdrawal. One might argue, therefore, that it is clear that those who take out such policies are paying more than the general market price for them.

If that is the case, does s.10 protect against an inheritance tax charge? Section 10 provides:-

> "(1) A disposition is not a transfer of value if it is shown that it was not intended, and was not made in a transaction intended, to confer any gratuitous benefit on any person and either -
> (a) that it was made in a transaction at arm's length between persons not connected with each other, or
> (b) that it was such as might be expected to be made in a transaction at arm's length between persons not connected with each other.
>
> ……………………………………
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> (3) In this section -
> "disposition" includes anything treated as a disposition by virtue of section 3(3) above;
> "transaction" includes a series of transactions and any associated operations."

44 Unless s.10 (see below) has the effect that the making of the policy is not a transfer of value

45 In referring to the last Government's claim to have 'reformed' the Inheritance Taxation of trusts in 2006 we enter an altogether darker world of fantasy than the virtual world of unitised insurance policies

Where an insurance policy is taken out in order to be the subject of a gift, as is commonly the case in inheritance tax planning, it is clear that the provisions of s.10 cannot be satisfied. That is because sub-section 1 of that section does not look only at the disposition but also at the transaction or series of transactions of which it is a part. Where a policy is taken out with the intention of it being subject to a subsequent gift which is in fact made, it is clear that it is part of a series of transactions and that that series of transactions was intended to confer a gratuitous benefit on a person. So s.10 will not prevent either the client who makes a bad bargain in taking out an insurance policy or who takes out a No Surrender Value Policy from making a transfer of value if that policy is taken out with the intention that it will be the subject of a subsequent gift.

There is a further argument in relation to the No Surrender Value Policy which might protect from an inheritance tax charge. One presumes that the company sells a reasonable number of such policies to a variety of persons who are willing to accept worse terms than those which apply to most policyholders[46] because of the tax advantages which the arrangement offers. Even so, one might expect individuals taking out such policies to negotiate with the insurance company to force an improvement in the other terms of the policy. Applying the classical economic assumption of a perfect market one would expect the insurance company to be willing to offer such enhanced terms. If it is not, it is surely because the group of potential policyholders to whom the product is relevant is too small for it to be worthwhile for the insurance company to offer special terms. In effect there is a market of those who wish to use No Surrender Value Policies for inheritance tax planning which is separate from the general market for investment bonds. So it may be, after all, that the premia paid by those who take out No Surrender Value Policies are indeed set at market prices.

Be that as it may, where an individual takes out a policy, there *is* an immediate chargeable transfer and he subsequently makes a gift of that policy, there will be an element of double counting because of the application of s.167 to the subsequent gift. The following example illustrates the point.

Example

Mr Keeve takes out an investment bond on his own life paying a premium of £1m. The market value of the bond and its surrender value immediately upon issue is £950,000. A few days later, he makes a gift of the bond on bare trusts for his children when the market and surrender values are unchanged. A year later he dies unexpectedly early. A death benefit of £950,000 is paid under the policy.

On taking out of the bond he makes a chargeable transfer of £50,000 (£1m - £950,000). On making a gift of the bond he makes a potentially exempt transfer which proves to be chargeable by virtue of his death. Because that is a lifetime transfer which has resulted in the policy ceasing to be part of Mr Keeve's estate, s.167 applies in determining the value of the policy. The effect of s.167(1) is that the policy is not to be valued at less than the previous premium paid of £1m. So Mr Keeve had made aggregate chargeable transfers of

[46] In the sense that the surrender rights are excluded with no corresponding reduction in the premium or increase in other benefits

£1,050,000, in spite of the fact that the policy has not, at any time, been worth, or had, a surrender value above, £950,000. The problem would be avoided if immediately upon issue the policy were held beneficially for the intended donee. If the policy is governed by UK law, that would only be possible if on issue the policyholder has an insurable interest in the life of the life assured under the policy.[47] Under the laws of many other jurisdictions, however, a policy is not void for lack of an insurable interest so there is much greater freedom for the policy to be held beneficially on issue by a person other than the life assured.

Regular premium, whole of life policies

Section 167 can also have a peculiar effect in respect of regular premium whole of life policies. In such policies the insurance company will always set the premia at a level where, in the early years, the premium charged in each year will be greater than that which would be charged, in a perfect market, for a single year's cover and this will reverse in later years. If one looks at each individual year, the premium one pays in an early year could be regarded economically as being paid partly for life cover in that year and partly for life cover in future years. In the early years the policy will have some market value but its market value will be less than the total of the premia previously paid under the policy. So on a transfer of the policy, s.167 is likely to impose a higher value on that transfer than the market value of the policy transferred. Section 167(3) provides an exception to the valuation rule of the section for certain policies but that sub-section applies only to term policies.

The following example illustrates the point.

Example

Mr Chapeau-Brun is forty years old and takes out a whole of life policy on his own life for a level sum assured of £1,000,000. The annual premium is £8,200. When he is fifty years old he gives the policy to his son who will of course have to continue to pay the premia to maintain the policy. If the father were to take out a similar whole of life policy at the time of the gift the annual premium would be £13,000. The policy has a market value at this time of £60,000 reflecting the fact that a person buying it would receive £1,000,000 on Mr Chapeau-Brun's death and would only have to pay £8,200 per year until that time in order to do so.

The total premia paid under the policy to date have amounted to £82,000 (£8,200 x 10) so that the amount of Mr Chapeau-Brun's potentially exempt transfer is that amount, although the asset he has transferred has a market value of just £60,000.

It is clear that even in relation to quite straightforward life insurance policies, s.167 can have really quite surprising results. The valuation of insurance policies for inheritance tax purposes is less straightforward than at first appears.

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[47] Life Assurance Act 1774 s.1