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IBC CONFERENCE: OFFSHORE TAXATION – A BRAVE NEW WORLD

SESSION 12

‘OVERSTEPPING THE LINE’

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SECTION I

RESISTING GOLIATH

MORALITY AND HMRC

1.1.1 In 2003 I gave the Hardman Lecture on the subject, Morality and Tax Practice deliberately dealing with, not only morality and the behaviour of tax professionals but also with the morality and the behaviour of what was then the Inland Revenue. Ironically, it became clear later that about that time HMRC launched a concerted campaign of misinformation designed to obfuscate the distinction between tax avoidance and evasion and to convince the public of their equal immorality. Its campaign accelerated with the formation of Her Majesty's Revenue & Customs in 2005 which inherited the worst characteristics of both organisations and received a further boost when governments worldwide found the international tax planning industry a convenient scapegoat for their own incompetence in failing to anticipate the international financial crisis. Twelve years later, governments have created an effective international cartel to prevent tax competition. In this country, HMRC has greatly extended the scope of arbitrary appropriation through taxation and has vastly increased its power to intrude into the everyday affairs of taxpayers.

A FANTASY WORLD

1.2.1 The picture of our taxation system given on television, in the newspapers and online bears less and less relationship to reality. Presented with this fantasy world, the public has developed a new fascination with taxation unleavened by knowledge and tax planners and their clients have found themselves the subject of an opprobrium based on equal quantities of anger and ignorance. Reacting to the public mood, the Courts have become ever more hostile to tax planning so that victories by the taxpayer in cases concerning tax avoidance, although still occurring occasionally, have become rare.

1.2.2 Those who practice in taxation may well feel that they are fighting an unequal battle against the philistine Goliath; but then we might remind ourselves that Goliath was defeated by a youth with a slingshot.

WHAT CASE LAW REVEALS

1.3.1 Tax cases are revealing of the types of behaviours one can expect from the HMRC Goliath. In this concluding talk I shall review a series of cases which involve behaviour by HMRC which is, in one way or another, shocking: shockingly artificial constructions of legislation, a shocking reliance upon legislation to tax in ways which ignore the economic substance of transactions, utterly unconscionable and untrustworthy behaviour and shocking incompetence. Even in cases which do not involve artificial tax planning, HMRC have, in spite of their behaviour, usually been the victors. This selection, however, includes some cases in which the tribunal or the court has applied a robust common sense in the taxpayer's favour. Win or lose, all of these cases are instructive in one way or another.

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SECTION II

ABUSIVE TAX COLLECTION

INTRODUCTION

2.1.1 In recent years we have heard much about abusive tax arrangements, often allegedly involving transactions with no commercial purpose designed to take advantage of literalist constructions of legislation to frustrate its purpose. A review of case law reveals many examples of abusive tax collection, strained and literalist constructions of legislation, subjecting to taxation mere arithmetical differences which bear no relation to economic substance.

ANSON v HMRC

2.2.1 *Anson v HMRC*[1] concerned a Delaware Limited Liability Company of which Mr Anson was a member. This Delaware LLC carried on a trade in the United States and was classified as a partnership for US tax purposes with the result that Mr Anson was subject to US income tax on his share of its profits as arising directly to him. Mr Anson was resident in the UK and not in the US and accepted that he was subject to UK income tax on his share of the Delaware LLC's profits although, as a non-UK domiciliary, on the remittance basis. The profits were in fact remitted and Mr Anson included them on his self-assessment returns for the relevant years which were in 1997/98 to 2003/04. He claimed Double Taxation Relief under art. 23(2) of the 1975 US/UK Double Tax

[1] *Anson v HMRC* [2015] UKSC 44

Convention and, in respect of the final year, under the similar provisions of the successor Convention. Article 23(2)(a) provided that:-

> 'United States tax payable under the laws of the United States and in accordance with the present Convention, whether directly or by deduction, on profits or income from sources within the United States … shall be allowed as a credit against any United Kingdom tax computed by reference to the same profits or income by reference to which United States tax is computed.'[2]

2.2.2 So Mr Anson was a member of an American entity which the Americans understood to be akin to a partnership and received his share of the profits on the trading venture which was carried on by the LLC. In ordinary usage one would say that those profits were taxed in both the UK and the US. He accepted that would be the case, but simply expected that there would be some relief from double taxation provided by the Treaty between the two countries made for just that purpose. HMRC, however, contended that because the Delaware LLC was in their view 'opaque', Mr Anson's income was from a source which was different to that from which the Delaware LLC's income, deriving, not from its trading activities, but from his rights as a member of the LLC. Accordingly they contended that relief was not due.

2.2.3 HMRC had begun their enquiries in November 2002. In 2010 the matter was heard before the First-tier Tribunal.

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2 *Anson v HMRC* [2015] UKSC 44 para. 28

2.2.4 Both taxing statutes and treaty provisions are to be interpreted purposively. That is clear from case law in respect of taxing statutes and, in respect of treaties, from the Vienna Convention on the Law of Treaties[3] art. 31 which provides:-

> 'A Treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the Treaty in their context and in the light of its object and purpose.'[4]

2.2.5 The First-tier Tribunal distinguished between the profits of a business which is the arithmetical difference between its income and expenses and the assets which represent those profits. It found that the interest of a member in the LLC was most similar, not to share capital, but to partnership capital in a Scottish partnership, that the LLC Agreement allocated the profit to its members as it arose and required those profits to be paid to the members and that, once the conditions for their distribution had been satisfied, the LLC had no discretion as to whether the payment should be made or not. Having decided that it is unsurprising that the FtT found that Mr Anson was:-

> ' … taxed on the same income in both countries and [was] entitled to double taxation relief …'[5]

2.2.6 More than five years later, seventeen years after the first profits at issue had arisen, and thirteen years after HMRC had opened its enquiry, the Supreme Court came to the same decision, HMRC having been successful in the Upper Tribunal and the Court of Appeal.

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3 Vienna, 23rd May 1969; TS 58 (1980) Cmnd 7964
4 Vienna Convention on the Law of Treaties, Vienna, 23rd May 1969; TS 58 (1980) Cmnd 7964 Art. 31
5 *HMRC v Anson* [2012] UKUT 59 (TCC), para. 1

2.2.7 In the Upper Tribunal, Mr Anson's Counsel seems to have excited the hostility of Mr Justice Mann in advancing a rather ingenious subsidiary argument based on the transfer of assets abroad legislation then found in ICTA 1988 s.739. There is no suggestion in the Case Reports that any of Mr Anson's arrangements were designed with tax avoidance in mind but the attempt of his Counsel to invoke an anti-avoidance provision to his benefit seems to have infuriated Mr Justice Mann who recorded with some satisfaction that the result of his original judgment was that Mr Anson:-

> '… was not entitled to double taxation relief, with the effect that … he sustained US tax at the rate of 45% on income distributions from the Delaware entity, and then further UK tax (at 40%) on the balance which was remitted to this jurisdiction. The result is that for every 100p paid out in income, 45p is paid in US tax and 22p is paid in UK tax.'

2.2.8 That sets out very starkly the result of the position for which HMRC was contending. When tax planners attempt to obtain a deduction in two countries for a single expense or loss, HMRC characterises their actions as treaty abuse; what is an attempt to subject Mr Anson's return on his investment to tax at 67% other than abusive tax collection?

TRIGG v HMRC

2.3.1 *Trigg v HMRC*[6] was another case in which HMRC contended for a narrowly literalist construction of the relevant statutory provisions in an attempt to defeat their purpose. Mr Trigg was a member of an investment partnership which was formed to take advantage

6 *Trigg v HMRC* [2014] UKFTT 967 (TC)

of an opportunity to purchase in the secondary market certain company loan notes which the partners thought were undervalued. In due course they made profits on disposals of these loan notes. The question at issue was whether the loan notes were qualifying corporate bonds within TCGA 1992 s.117 in which case any gain on their disposal would be exempt from Capital Gains Tax and any loss would not be allowable.

2.3.2 They were, except perhaps in one feature, absolutely conventional corporate loan notes. The one feature in which they might be thought to differ from the norm was that they contained provisions designed to take account of the possibility that the UK might adopt a new currency and, in particular, might join the Euro. In the case of an adoption of another currency generally:-

> ' … references in, and obligations arising under, the notes … [were to be] … converted into, and/or any amount becoming payable under the notes; … [were to] be paid in, the currency or currency unit of the United Kingdom …'[7]

2.3.3 Any such conversion was to be made at the official rate of exchange recognised for that purpose by the Bank of England.

2.3.4 In the event that the UK adopted the Euro as its lawful currency the issuer of the bond could designate a 'redenomination date' with the result that the notes were to be deemed to be 'redenominated in Euros at the conversion rate established by the Council of the European Union, and coupons and interest would be reissued or paid in Euros'.[8]

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7 *Trigg v HMRC* [2014] UKFTT 967 (TC), para. 9
8 *Trigg v HMRC* [2014] UKFTT 967 (TC) paras. 12 & 13

2.3.5 HMRC argued that because of these provisions s.117(1)(b) was not satisfied. Section 117(1)(b) provides that, to be a corporate bond within s.117 a bond must be one:-

> 'which is expressed in sterling and in respect of which no provision is made for conversion into, or redemption in, a currency other than sterling …'

2.3.6 Section 117(1)(b) is further modified by s.117(2) which provides:-

> 'For the purposes of subsection (1)(b) above -
>
> ...
>
> (b) a provision for redemption in a currency other than sterling but at the rate of exchange prevailing at redemption shall be disregarded.'

2.3.7 Read literally, s.117(2) did not cover the corporate bonds' conversion provisions, because neither provided for the sterling/foreign currency exchange rate ruling at the time of redemption to be used, for the very good reason that the purpose of the provisions was to deal with the situation which would rule if sterling ceased to exist before redemption.

2.3.8 On a purely literal reading, HMRC was, therefore, correct but Judge Mosedale identified the purpose of the provision as being to give a favourable treatment to what he called 'British Bonds'. In order to give effect to that purpose the phrase 'currency other than sterling' in s.117(1)(b) had to be read as containing an implied condition that sterling had to exist as the UK's lawful currency at the time of conversion/redemption in another currency. So the FtT preferred the purposive construction contended for by the taxpayer of the legislation to the narrowly literalist one contended for by HMRC.

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2.3.9 HMRC, however, hasn't abandoned its attempt to defeat the purpose of this legislation. It has appealed to the Upper Tribunal.

<u>THE QUEEN (ON THE APPLICATION OF ANDREW MICHAEL HIGGS) v HMRC</u>

2.4.1 Our next case is an attempt by HMRC which ranks still higher on the scale of abusive tax collection. *The Queen (on the Application of Andrew Michael Higgs) v HMRC*[9] was an attempt by HMRC to retain moneys paid by a taxpayer which it admitted were in excess of the tax liabilities in satisfaction of which it was paid.

2.4.2 Mr Higgs made payments on account (based on his previous year's tax liability) which turned out to be too high. For complex reasons he did not submit a self-assessment return for the year concerned until more than four years after its end. There was no dispute as to the amount shown as chargeable in the return or that, if the return included a self-assessment, an amount of tax was repayable to Mr Higgs. HMRC, however, said TMA 1970 s.34 applied so that Mr Higgs statement of the amount on which he was chargeable to Income Tax and Capital Gains Tax for the year concerned in his tax return did not amount to a self-assessment. If HMRC had been correct the result would have been that there was no difference between the amount of Income Tax and Capital Gains Tax contained in Mr Higgs' self-assessment under TMA 1970 s.9 for the year concerned and the aggregate of his payments on account in respect of that year and therefore no amount which was repayable to him under TMA 1970 s.59B.

[9] *The Queen (on the Application of Andrew Michael Higgs) v HMRC* [2015] UKUT 92 (TCC)

2.4.3 Section 34 provided that:-

> '(1) Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case, an assessment to income tax or capital gains tax may be made at any time not more than 4 years after the end of the year of assessment to which it relates.
>
> (2) An objection to the making of any assessment on the ground that the time limit for making it has expired shall only be made on an appeal against the assessment.'

2.4.4 The Case Report made a close and substantial analysis of the relevant provisions taking in full account of their purpose. It concluded:-

> '... I have reached the conclusion that the Claimant's interpretation of s.34(1) is to be preferred, and therefore that the time limit in that subsection has no application to a self-assessment such as that which the Claimant made in this case. That interpretation is consistent with the natural reading of the section as a whole, including s.34(2) which admittedly has no application to self-assessments. It is also consistent with the placing of this section alongside other sections such as s.36 which relate exclusively to assessments by HMRC. Further, the interpretation espoused by HMRC would result in inconsistency with other provisions of the TMA, including those which contain different time limits such as s.8 and s.28C. For these

reasons, far from being satisfied that the conclusion reached by Patten J in *Morris* as to the scope of application of s.34(1) was wrong, I agree with it.'[10]

2.4.5 Before the FtT, although not in discussions with the taxpayer leading up to the hearing, HMRC had admitted that, if the time limit in s.34 applied, it had a discretion to extend it. It had not done so. The FtT further found that if it were wrong on its substantive decisions as to the construction of s.34(1):-

> '… the matter should be remitted to HMRC for them to give full and proper consideration to whether it would be appropriate to exercise their discretion to extend the time limit so as to permit the Claimant's self-assessment and repayment claim to be processed. In so considering the matter, HMRC should have regard (in addition to the factors relevant to whether the Decision amounts to a disproportionate interference with the Claimant's rights under A1P1) to all other relevant factors urged by the Claimant …'[11]

2.4.6 So here we have a case in which HMRC had adopted a strained and unnatural construction of a provision which was inconsistent with persuasive case authority or with related statutory provisions in order to retain moneys paid by a taxpayer in excess of the amount on which he was chargeable for the year concerned. What is more, even if its incorrect construction had been correct, it had failed to properly consider whether to exercise its discretion to allow the self-assessment to be made which would have enabled it to repay the excess to the taxpayer and had failed in the process to make any consideration of the relevant provisions of the ECHR.

10 *The Queen (on the Application of Andrew Michael Higgs) v HMRC* [2015] UKUT 92 (TCC) para. 46
11 *The Queen (on the Application of Andrew Michael Higgs) v HMRC* [2015] UKUT 92 (TCC) para. 63

EXECUTORS OF LEADLEY DECEASED v HMRC

2.5.1 The case of the *Executors of Leadley Deceased v HMRC*[12] was a case in which HMRC unsuccessfully attempted to exploit what, had it been correct, would have been an anomalous fault in the legislation resulting in the imposition of a charge on a purely notional net gain where no real net economic gain had been made. Mr Leadley had made investments in the shares of two companies and a loan to a third. The shares had become valueless, and the loan 'effectively ceased to exist as an asset',[13] by 5th April 2010.

2.5.2 TCGA 1992 s.24 provides for a negligible value claim to be made, where an asset has become of negligible value, to treat the asset as having been disposed of, and reacquired, at that value. ITA 2007 s.131, allows a capital loss on certain shares to be set off against the claimant's income. Capital losses on debts arising to the original creditor are not generally allowable for Capital Gains Tax purposes but TCGA 1992 s.253 allows a claim to be made to treat an amount which has become irrecoverable on certain loans as if it were an allowable capital loss.

2.5.3 Had Mr Leadley made claims under TCGA 1992 ss.24 and 253 it does not appear that there would have been any dispute that these reliefs applied. Mr Leadley, however, was unfortunate enough to die in a motoring accident on 11th May 2010 before he had made the appropriate claims and they were instead made by his executors. HMRC claimed that the negligible value claim could only be made by the person who owned the shares

[12] *Drown and another (Executors of Leadley Deceased) v HMRC* TC 4007 [2014] UKFTT 892 (TC)
[13] *Drown and another (Executors of Leadley Deceased) v HMRC* TC 4007 [2014] UKFTT 892 (TC), para. 4

at the time they became of negligible value and, similarly, that the s.253 claim could only be made by the person who had made the loan. Being dead, Mr Leadley was not in a position to make either.

2.5.4 In respect of the negligible value claim the FtT concluded that:-

> '… a purposive interpretation of s 24 TCGA and s.131 ITA is that the personal representatives of the deceased are treated *as* the deceased in so far as they are returning the deceased's own tax liability.
>
> ...
>
> As the executors do stand in the shoes of the deceased person in so far as his pre-death tax chargeability is concerned, for the purposes of s.131 the executors are an "individual" (as representatives of Mr Leadley) making the claim; for the purposes of s.24 the executors are treated as representing Mr Leadley, who was the owner of an asset which became of negligible value while owned by him.'[14]

2.5.5 In respect of the claim under s.253 it found that:-

> 'While the wording of s.253 differs from that of s.24 TCGA and s.131 ITA, the same point arises. Mr Leadley made the loan. At the date of the claim the loan had become irrecoverable. But the "claimant" is the personal representatives in the sense that it was the executors who completed the 09/10 return, Mr Leadley having died.

[14] *Drown and another (Executors of Leadley Deceased) v HMRC* TC 4007 [2014] UKFTT 892 (TC), paras. 59 & 60

All the same considerations arise as I have set out above. I consider that a purposive reading of s.253 TCGA should be the same as I have given s.24 TCGA: in other words, the personal representatives are representing Mr Leadley when submitting a return of the deceased's tax chargeability and, as representing Mr Leadley, are able to make, effectively on his behalf, the claims which he could have made had he lived.'

2.5.6 Again, HMRC has not abandoned its attempt to defeat the purpose of this legislation. It has appealed to the Upper Tribunal.

ANDERSON v HMRC

2.6.1 The chargeable events regime in respect of life insurance and capital redemption policies is a fruitful field for artificial tax collection by HMRC.

2.6.2 In *Anderson v HMRC*[15] the appellant had taken out life insurance policies issued by an Irish insurance company. The aggregate amount which he received on his withdrawals from the policies and their surrender was less than his original investment. So, in economic terms he had made a loss on his policies.

2.6.3 He took out the policies when he was not resident in the UK but he later became resident here and made withdrawals under the policies in excess of the 5% allowance for the relevant tax year which meant the whole of the excess was a chargeable event gain and

15 *Anderson v HMRC* TC 2555 [2013] UKFTT 126 (TC)

was taxed in the year that the part surrender was made. As they were offshore policies, the appellant was liable to Income Tax at the basic rate as well as the higher rate of 40%.

2.6.4 In addition, the appellant's largest policy was a personal portfolio bond (a 'PPB') with the result that, in addition to any actual chargeable event gains that arose on the policy, he was charged to tax each year as if there were an actual gain of an amount equal to 15% compound of the premia paid less the aggregate amount of any previous part surrender gains, irrespective of whether the policy gave an actual gain of that amount, or indeed any return at all.

2.6.5 PPB gains are deducted, in addition to part surrender amounts, in computing whether there is a final gain in the year the policyholder ceases to have any rights in the policy and its amount if any. Where, however, there is no gain but a deficiency, although the appellant is entitled to claim corresponding deficiency relief, the PPB gains are not included in the amount of previous gains in calculating the relief. Furthermore, the deficiency relief at the end of the policy is calculated as a tax reduction based on the difference between the basic rate and higher rate of tax, even though the previous gains will have been taxed at both the basic and higher rates. So the relief for a final deficiency is both asymmetric and restricted.

2.6.6 The appellant appealed contending, *inter alia*, that:-

- the provisions breached his right to the peaceful enjoyment of his property under art. 1 of the First Protocol to the European Convention on Human Rights and Fundamental Freedoms;
- they also breached his rights under art. 14 of the Convention;

- the legislation was unjust and did not produce the results intended by Parliament;
- in all the circumstances, it would be fair and equitable for HMRC to write off the relevant tax liability.

2.6.7 In finding for HMRC, the FtT held, *inter alia*, that the tax regime applicable to any kind of investment might make it suitable for one category of persons but unsuitable for another. That did not mean that the tax regime violated the rights under art. 1 of the First Protocol of the Convention of persons to whom it applied because such persons remained free to make alternative investments more suited to their particular circumstances.

2.6.8 The Tribunal said that Mr Anderson was:-

> '... not the first appellant to come before this Tribunal or its predecessors to complain of the workings of the chargeable event regime where large part-surrenders are made'.[16]

2.6.9 He was though liable for the tax. The human rights argument amounted, said the Tribunal, to a claim that:-

> '... the normal tax law should not be applied to [the taxpayer], on the ground that he has unintentionally put himself in a situation which has disadvantageous tax consequences as a result of bad advice and lack of knowledge of the applicable tax law'.[17]

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[16] *Anderson v HMRC* TC 2555 [2013] UKFTT 126 (TC), para. 21
[17] *Anderson v HMRC* TC 2555 [2013] UKFTT 126 (TC), para. 27

2.6.10 The Tribunal went on to comment on the part-surrender legislation, noting:-

> '... the system of taxation of part-surrenders in excess of the 5% allowance is one which penalises the unwary or ill-advised, often with quite disproportionate consequences as in this case. HMRC, and for that matter the insurance industry, have been aware of this major fault in the system for many years but have done nothing to correct it. In correspondence with the appellant's MP, the director of HMRC CT and VAT, Jim Harra [who was named tax personality of the year in this year's *Taxation* Awards], said:-
>
> > "… the 5% rule … continues to be popular with many insurers and their investors. Proposals on a couple of occasions to abolish the 5% rule have not been pursued."'
>
> Quite apart from the odd notion that it is the rule's popularity with insurers that should allow the iniquitous effect of a large part-surrender to be visited on taxpayers, the reply completely misses the point. The iniquitous effect of large part-surrenders can clearly be removed without affecting the operation of the 5% rule in those cases in which it was intended to apply as a relief. What is more, the rules for corresponding deficiency relief are in most cases a wholly inadequate remedy for the disproportionate consequences of a large part-surrender, even where they are not *prima facie* discriminatory.'[18]

[18] *Anderson v HMRC* TC 2555 [2013] UKFTT 126 (TC), para. 34

LOBLER v HMRC

2.7.1 *Anderson* is a case of the artificial assessment of purely notional gains where there was no real economic income whatsoever. The most egregious example of HMRC's use of the chargeable event provisions to assess notional gains, however, is surely *Lobler v HMRC.*[19]

2.7.2 The appellant was a Dutchman who moved, with his family, to work in the UK in 2004. He sold his house in Holland for the equivalent of £350,000. The report of the FtT hearing reveals that this represented his 'life savings'.[20] On the advice of HSBC Private Bank he borrowed a further $700,000 from HSBC and invested the combined amount, about $1,400,000, in an offshore insurance policy on 1st March 2006. Over the next two years he made partial surrenders of each policy of almost the entire investment in the policy, withdrawing in total $1.4 million.

2.7.3 As a result of the way chargeable event gains are calculated under ITTOIA 2005 Ch 9, Pt 4, because these were partial withdrawals, they resulted in the taxpayer being treated as having income equal to almost the entire amount of his receipt and being liable to Income Tax equivalent to $560,000.[21] He surrendered the policy in its entirety in July 2008 and received a further $35,000. A deficit for Income Tax purposes arose in the final year of the policy of roughly $1,230,000 but this was of no use to the taxpayer who had insufficient income against which to offset it.

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19 *Joost Lobler v HMRC* [2015] UKUT 152 (TCC)
20 *Joost Lobler v HMRC* [2015] UKFTT 141, para. 6
21 It is an oddity of the FtT's report that it translates the amounts used in, or resulting from, the computation of Mr Lobler's tax liability into US dollars

2.7.4 The net result was that he had received back a little less than the amount of his investment and, after repaying the loan, his net receipt was equal to about $725,000. Therefore, taking account of his Income Tax liability, if the assessment had stood he would have been left with about $165,000 ($725,000 - $560,000) less whatever interest and penalties would have exigible on his tax liability and the costs of his discussions with HMRC and of his subsequent appeal.

2.7.5 The FtT explained that the taxpayer:-

> '… made no profit or gain as that term is commonly or commercially understood and yet he becomes liable to pay tax which exhausts his life savings and may bankrupt him. That is an outrageously unfair result.
>
> The appeal takes place at a time when there is great media and political comment about a fair tax system. That interest focuses on the avoidance of tax by those who have substantial income, but to our minds it is more repugnant to common fairness to extract tax in Mr Lobler's circumstances than to permit other taxpayers to avoid tax on undoubted income.'

2.7.6 The FtT found that the relevant legislation was a prescriptive code which brought into tax amounts calculated under the provisions of the Chapter which bore no resemblance to 'gains' in common or commercial parlance. The calculation under ITTOIA 2005 s.507 produced a gain equal to the amount received less 5% of the premium originally paid. No different interpretation could be applied to the legislation.

2.7.7 The FtT did its best to find a basis on which it could decide in Mr Lobler's favour. It first considered the equitable remedy of rectification but found that because Mr Lobler and the insurance company could not have been said to have a common intention to make a full surrender the conditions for its application did not apply.

2.7.8 The Human Rights Act 1998 s.3 required that so 'far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with' relevant rights under the Convention for the Protection of Human Rights and Fundamental Freedoms[22] (as set out in HRA 1998, Sch1). These included Art 1 of the First Protocol which provided that every person was entitled to the peaceful enjoyment of his possessions save as a State deems necessary to secure the payment of taxes. The FtT explained:-

> 'It seems to us that the effect of the legislation as described above on Mr Lobler is so outrageously unfair that it may not fall within that exception for the collection of taxes. But even if that is the case, there is nothing we can do about it.'

2.7.9 First, the duty to construe the legislation in accordance with the Convention was 'so far as it is possible to do so'. The legislation in Ch 9 was so prescriptive that it was not possible to construe it any other way. Its object was to deprive the appellant of those monies whatever their nature. There was no room for even robust interpretation. Second, even if the FtT had concluded that the legislation produced a result that was not compliant with Convention rights, it had no jurisdiction to make such a declaration. HRA 1998 s.4 gave a jurisdiction to the High Court and above. Third, s.6(2) provided that s.6

[22] As set out in HRA 1998, Sch.1

did not apply if, as a result of one or more provisions of primary legislation, HMRC could not have acted differently. The FtT considered that HMRC in the present case could not have acted differently in their interpretation of the legislation, but it might be arguable that they could have decided not to make the changes to the appellant's self-assessment under their power of management of the tax system in TMA 1970 s.1. The jurisdiction given to the FtT, however, did not extend to making orders to overturn (or 'review') the administrative processes of HMRC. Only the High Court had that jurisdiction. The Tribunal concluded:-

> '... thus with heavy hearts we dismiss the appeal.'[23]

2.7.10 As the Tribunal said, it is at least arguable that in these exceptional circumstances, HMRC:-

> '… could have decided not to make the changes to Mr Lobler's self-assessments in reliance on their power of management of the tax system in section 1 Taxes Management Act 1970.'

2.7.11 So it appeared, after the FtT hearing, that a foreign national who was the subject of our hospitality had lost his life savings because HMRC chose to take a case it might properly not have taken. Was there nobody in HMRC who felt any moral qualms about that decision?

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[23] *Joost Lobler v HMRC* [2015] UKFTT 141, para. 28

2.7.12 Mr Lobler was rescued from his predicament by the Upper Tribunal in which Mrs Justice Proudman allowed Mr Lobler's appeal. She did so on the grounds that had Mr Lobler made an application for rectification, that application would have been granted on the ground of mistake. No doubt that was a relief for Mr Lobler and it seems that HMRC will not compound the wrong it has done to him by appealing the decision, but there are several difficulties with the grounds of Mrs Justice Proudman's decision.

2.7.13 Mr Lobler's policies had given him four alternative options in making a surrender. The option he chose was a partial surrender of all of the policies which he held specifying particular 'funds' which were to be treated as the subject of disposals for the purposes of calculating the surrender proceeds. Mrs Justice Proudman had found that this was a unilateral mistake. Because Mr Lobler exercised a right under the policy which did not require the insurance company's consent, she found that it was not a requirement for the grant of the remedy of rectification that Mr Lobler and the insurance company should have had a common intention vitiated by the mistake. As we have said, Mrs Proudman did not actually grant the remedy of rectification. She simply found that Mr Lobler would have been entitled to rectification if he had made an application to the Court for that remedy and that his tax position was to be determined as if the remedy had been granted. She did so by analogy with cases such as *Oughtred v IRC* [1960] and *Jerome v Kelly* [2004] which concerned situations in which the Court, in deciding the taxation consequences of transactions, had taken account of the fact that the taxpayer could have obtained an order for specific performance. That seems to be a misguided analogy. Where specific performance would be granted, beneficial ownership must necessarily already have passed under the doctrine of the estate contract.

2.7.14 The Tribunal's decision that it could determine the tax consequences of Mr Lobler's actions as if rectification had been granted although it had not, indeed, although it had not even been applied for, provides an opportunity for taxpayers in cases of faulty execution, including faulty execution of tax schemes, to argue that the transactions concerned should be taxed as if an order for rectification had been made.

2.7.15 A particular difficulty with Mrs Justice Proudman's decision that rectification would have been granted to Mr Lobler had he applied for it is shown when one asks, what would have been the nature of the rectification which the Court would have granted in Mr Lobler's case? Mrs Justice Proudman said that if Mr Lobler had not exercised the option which he did by reason of his mistake 'it seemed [to her] ... that he would have chosen Option D on the form'. Option D was to make full surrenders of sufficient policies so as to result in surrender proceeds of a specified amount. She did not in words say that the rectification which the Court would have granted was to treat Mr Lobler as if he had exercised Option D but that seems to be the implication of her comment. The trouble with that is that although the amount paid on his partial surrender would have been unaffected by which option was exercised, the amount payable when Mr Lobler subsequently made a full surrender of the policies would have varied from the amounts in fact paid. That is because the policies were conventional policies under which the surrender values were to be calculated by reference to a notional basket of assets (the 'funds') and there would have been a difference in the funds notionally left in the policies after the surrenders according to which option was exercised. It is difficult to see, therefore, how a Court could have ordered such a rectification in respect of a unilateral mistake which would have had the result that the insurance company would not have paid the correct amount on the final surrender.

2.7.16 Perhaps the more important difficulty with the Upper Tribunal's decision is that the Court decided that there was no breach of Mr Lobler's rights under the ECHR. The CIOT has long been concerned at the unfair consequences for many policyholders of the chargeable events legislation. It made an application which was granted under Rule 5(3)(d) of the Upper Tribunal Rules 2008 to permit it to make written submissions to the Upper Tribunal in the case although it was not a party to it. Mrs Justice Proudman at the Hearing gave a direction that Counsel for the CIOT, Miss McCarthy, be permitted to address the Tribunal orally. This she did and argued, as Counsel for the taxpayer did also, that the assessment breached Mr Lobler's human rights under Art. 1 Protocol 1 (A1P1) of the ECHR which provides a right to the peaceful enjoyment of one's possessions. That right is subject to the public interest and to the rights of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

2.7.17 In deciding whether this right is breached the State is to be given a wide margin of appreciation. Mrs Justice Proudman found that:-

> ' … in order for [the provisions relating to the taxation of policyholders] to amount to a breach of an ECHR right, the interference with that right must be "devoid of reasonable foundation" '[24]

[24] *Joost Lobler v HMRC* [2015] UKUT 152 (TCC), para. 83

2.7.18 Mrs Justice Proudman found that:-

> 'The means employed to achieve the public interest in this case amount to depriving Mr Lobler and his family of all their personal finances and leaving him in a state of possible bankruptcy. Each case must be considered individually on its own merits. Is it possible to conclude that the legislation in question is generally "devoid of reasonable foundation"? In my view the scales tip, only just, in favour of reasonable foundation because the law is not irrational or arbitrary.'[25]

2.7.19 But if each case must be considered individually on its own merits, it is difficult to see how a law which results in an individual and his family being deprived of all of their personal finances leaving him in a state of possible bankruptcy when he has made an insubstantial real economic profit can be anything other than generally 'devoid of reasonable foundation'.

2.7.20 So it is rather difficult to see why Mrs Justice Proudman felt that the scales, which she admitted were almost evenly balanced, should tip in favour of HMRC.

2.7.21 In rejecting this Human Rights argument, Mrs Justice Proudman tipped the scales not only against Mr Lobler but also against other taxpayers similarly caught in the toils of these labyrinthine rules. That rectification might also be granted in their case is no answer to the plight of this class of taxpayers. Rectification is by its nature a remedy which turns on the particular facts and is discretionary so that it is likely that it will be difficult for a

[25] *Joost Lobler v HMRC* [2015] UKUT 152 (TCC), para. 90

taxpayer to establish that a Court would have granted the remedy had an application been made and that it will be very expensive for him to do so.

2.7.22 Timothy Jarvis of Squire Patten Boggs, writing in the *Tax Journal* of 15th May 2015, was of the opinion that the Upper Tribunal's judgment in *Lobler* that rescission for mistake was unavailable as a remedy because a third party (HMRC) benefitted from the mistake was inconsistent with the Supreme Court's judgment in *Pitt v Holt*. In *Pitt v Holt* the Supreme Court held that rescission for mistake was available on the facts with no regard to the fact that the third party, namely HMRC, benefitted from the mistake and the Supreme Court made no mention of a third party benefit being a barrier to a mistake claim.

2.7.23 The Upper Tribunal's finding in *Lobler* found that rectification was available also seems to have been inconsistent with *Pitt v Holt*, where the Supreme Court restated the traditional rule on rectification that it is:-

> ' … a closely guarded remedy, strictly limited to some clearly established disparity between the words of a legal document, and the intention of the parties to it. It is not concerned with consequences.'[26]

2.7.24 Timothy Jarvis comments that when Mr Lobler withdrew funds from his policies, he consciously knew he was making partial surrenders. The unforeseen tax charges were an error as to the tax consequences of that act. Therefore, the Upper Tribunal's judgment in *Lobler* on rectification sits uneasily with the legal test for the availability of the remedy

[26] *Pitt & Another v Holt & Another; Futter v Futter* [2013] UKSC 26, para. 131

set out by the Supreme Court in *Pitt v Holt* and in particular with the Supreme Court's statement that consequences are to be ignored.

2.7.25 Unfortunately, this very unsatisfactory judgement will stand as HMRC has decided not to appeal against it.

SECTION III

UNCONSCIONABLE BEHAVIOUR

INTRODUCTION

3.1.1 It must surely have been obvious to anybody that it was utterly unconscionable that Mr Lobler should have been assessed to such an excessive amount of Income Tax when he had made no significant economic gain whatsoever. In such circumstances, one would have hoped that the Revenue authorities would have bent over backwards to find a means to avoid that result. As we have seen, the First-tier Tribunal said it was at least arguable, in these circumstances, that HMRC could have decided not to make the changes to Mr Lobler's self-assessments in reliance on its power of management of the tax system. Instead, it not only chose to do so but also to oppose Mr Lobler's arguments both on rectification and under the Human Rights Act. This is not the only example of a case where HMRC's decision to litigate seems to have been utterly unconscionable. Indeed some of HMRC's decisions to litigate are shocking in its indifference to human suffering.

PARVEEN CHADDA AND OTHERS v HMRC

3.2.1 *Chadda and others v HMRC*[27] is just such a case.

3.2.2 The case concerned IHT on the estate of Mrs Tobin. She died after her husband and the question at issue concerned whether her estate included the entire freehold interest in

[27] *Chadda and Others v HMRC* [2014] UKFTT 1061 (TC)

her home (the 'Property') or, as the Tribunal in fact found, just a 50% interest as tenant in common subject to a liability equal to the nil-rate band owed to the trustees of a discretionary trust established under her husband's Will. That in turn depended on whether her joint tenancy in the property had been severed before her husband's death.

3.2.3 Mr and Mrs Tobin had a disabled daughter, Mary, who required 24-hour care. This care was provided by her mother, who at the relevant times until her death had a terminal heart condition, and her sisters who were also the executors. The severance formed part of some straightforward tax planning, designed to ensure that Mr Tobin's nil-rate band was not wasted, which was put in place because of Mr and Mrs Tobin's concern that, after their death, money should be available to provide care for Mary.

3.2.4 Unfortunately for Mary and the executors, the document of severance was later lost (although there was a draft in existence) and although the severance was correctly reflected in the Form IHT200 submitted on Mr Tobin's death, the person dealing with submitting the IHT200 on Mrs Tobin's death had overlooked it and had not reflected it in that return. The omission was subsequently discovered and corrected but, for reasons which are mysterious, HMRC simply declined to accept that the severance had been made. As Counsel for the taxpayer pointed out, HMRC had no suggestion to make as to what had actually happened had notice of the severance not been given.

3.2.5 Had HMRC's assertions been correct, a simple mistaken omission would have resulted in an entirely unnecessary tax charge of £112,000 reducing the money available to provide care for the severely disabled Mary.

3.2.6 Fortunately, the FtT rejected HMRC's submissions almost in their entirety.

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3.2.7 The law at issue was largely undisputed but on those issues which were in dispute, the FtT agreed with the taxpayers' Counsel.

3.2.8 HMRC impugned the accuracy and reliability of the evidence advanced by the taxpayer and of the inferences drawn from it from the taxpayer's Counsel. The Tribunal characterised various of HMRC's alternative inferences as 'unlikely' (para. 57) and as not 'at all probable' (para. 60). It found that the fact that the severance had been made was evidenced by the existence of a draft Notice of Severance, by subsequent email correspondence with the bank to which the property was mortgaged and by the witness statements and oral evidence of one of the executors and of the highly respectable partner of the accountancy firm advising the family. The Tribunal accepted this evidence in its entirety and the inferences which the taxpayers' Counsel drew from it. It was able to conclude that the severance had been given on all three of the grounds advanced by the taxpayers and resisted by HMRC.

3.2.9 So HMRC's submissions on the law and on the evidence, to the extent that they conflicted with those of the taxpayers, were rejected by the Tribunal. As this was a hearing before the FtT, one assumes that the costs of the hearing were not recovered by the executors. Thus the moneys available to care for Mary were reduced by these entirely unnecessary costs and the executors were subject to the demands on their time, inconveniences and strain which are the inevitable result of a Tribunal hearing.

3.2.10 On what basis could HMRC have decided that this was a suitable case to take to the Tribunal?

3.2.11 Two matters are of particular concern.

3.2.12 First, HMRC had sought, unsuccessfully, to exclude[28] the important secondary evidence on which the FtT had relied in finding that notice of severance had been given.[29] Had HMRC been successful in this submission, it might have been in the position of winning the case only because the FtTl was denied access to the relevant evidence.

3.2.13 Secondly, the case had been subject to a statutory review under TMA 1970 s.49B(2). That further confirms my experiences of such reviews that, except in the most egregious cases, they are simply exercises in one HMRC Officer rubber-stamping the decisions of another.

3.2.14 No doubt HMRC's actions were perfectly proper in the legal sense of not being an abuse of process. Taking wider ethical considerations into consideration, however, it is surely unacceptable for a department, which in carrying on the Queen's Government is entrusted with great resources and enormous powers, to act in such an unconscionable way to the detriment of such a vulnerable individual.

[28] *Chadda and Others v HMRC* [2014] UKFTT 1061 (TCC)
[29] *Chadda and Others v HMRC* [2014] UKFTT 1061 (TCC)

PITT v HOLT

3.3.1 The Supreme Court's decision in the joined cases of *Futter and another (Appellants) v HMRC; Pitt and another (Appellants) v HMRC*[30] was, of course, important for its restriction of the *Hastings-Bass* principle and its extension of the remedy for Mistake. One aspect of the case which has not received sufficient public comment, however, was HMRC's decision to litigate in the second of these cases, *Pitt v Holt.* The Supreme Court found that the *Hastings-Bass* Principle did not apply to Mr Pitt's settlement (see below) but avoided the transaction under the Doctrine of Mistake. The case raises serious questions about the extent to which a sense of basic morality informs HMRC's decisions to litigate.

The Facts

3.3.2 The facts of *Pitt v Holt* were tragic.

3.3.3 Mr and Mrs Pitt were persons of relatively modest financial resources, their only major asset being their home on which a large mortgage loan was secured. On the day of his 57th birthday, on 6th April 1990, Mr Pitt was badly injured in a road accident, suffering multiple injuries including very serious head injuries such that he became permanently unable to manage his own affairs and required twenty four hour care. After the accident he was, of course, unable to work and, because she had to care for her husband, so was Mrs Pitt.

3.3.4 Mrs Pitt was appointed as his receiver under the Mental Health Act 1983.

[30] *Futter and another (Appellants) v HMRC; Pitt and another (Appellants) v HMRC* [2013] UKSC 26

3.3.5 A damages claim against the driver was settled by agreement. It is clear from the facts that even with the award, their income barely exceeded the cost of Mr Pitt's care.

3.3.6 A firm of financial advisers advised Mrs Pitt to settle the amounts paid under the agreement on discretionary trusts primarily because this would avoid having to pay fees to the Court of Protection in respect of dealings with the invested fund. The financial advisers provided Mrs Pitt with a report on the Income Tax and Capital Gains Tax advantages of the proposed settlement but did not consider Inheritance Tax.

3.3.7 Having been authorised (but not directed) by the Court of Protection to do so, Mrs Pitt made the settlement.

3.3.8 Although it was not realised at the time, the settlement was a chargeable transfer triggering an IHT liability of about £100,000 which, had HMRC been successful in the case, might have been substantially increased by interest and penalties. Had the settlement been either an interest in possession trust or a trust complying with s.89 (trusts for disabled persons), no chargeable transfer would have arisen.

3.3.9 The settlement was a relevant property settlement subject to ten yearly and exit charges.

3.3.10 Mr Pitt died on 25th September 2007. At the time of his death, only £6,259 remained within the settlement.

<u>The Behaviour of HMRC</u>

3.3.11 Mrs Pitt was successful before the Supreme Court in that her husband's transaction was voided and no Inheritance Tax liability arose. In order to reach that point, however, Mrs Pitt had to suffer years of uncertainty, facing the prospect of a liability which, on the face of the facts revealed in the case, could have ruined her and deprived her of her home.

3.3.12 She first discovered the potential Inheritance Tax liability in 2003. Her disabled husband died in 2007. The High Court hearing took place on 21st October 2009. It is normal for cases to take several years before they come to Court, so it is reasonable to assume that Mrs Pitt was faced with the prospect of these proceedings before the death of her husband in 2007. For seventeen years she cared for a mentally disabled husband who had suffered a terrible misfortune. For the last four years of his life and for six years thereafter it would appear that Mrs Pitt would have had to bear the very considerable additional strain of facing potential financial ruin.

3.3.13 Apart from a point as to whether or not the *Hastings-Bass* Principle could apply to fiduciaries other than trustees, an argument HMRC quickly abandoned when it was roundly dismissed in the High Court, Mrs Pitt's circumstances fell squarely within the *Hastings-Bass* Principle as it was universally understood until the Court of Appeal gave its judgment in her case in 2011. The proceedings were only kept alive by the decision of HMRC to appeal against the High Court's decision. Both before the High Court's decision and after it, HMRC could quite properly have concluded that the facts of the case did not justify their incurring the risks of litigation. They did not need to litigate *Pitt* in order to obtain a review of the *Hastings-Bass* Principle by the Court of Appeal because they held the option of opposing the application in *Futter* and of appealing against the decision in that case on its own. HMRC's decision to appeal against the High Court's decision in *Pitt* gave them no advantage, wasted public money and subjected a woman who had suffered the most appalling misfortune to years of stress and strain during a period in which she was at first caring for her seriously disabled husband and then mourning his loss.

3.3.14 It is surely very disturbing that there were, as one presumes, individuals in HMRC who thought that was a reasonable course of action to take and that nobody in the Department saw fit to interfere with their decision.

SECTION IV

IS HMRC's WORD ITS BOND?

HMRC v SOUTHERN CROSS

4.1.1 Even when HMRC agree a settlement of a case one cannot assume that it will not attempt to renege on its undertaking. HMRC's word is only its bond when it is forced to keep it by the Tribunal or the Court. In the case of *HMRC v Southern Cross Employment Agency Limited*,[31] the taxpayer, Southern Cross Employment Agency Limited ('Southern Cross') had applied for a repayment of VAT it had paid on the grounds that it now considered that its supply of the services of agency nurses was an exempt, not a standard rated, supply. It agreed a settlement of the matter with an Officer of HMRC under which HMRC repaid it £1.4 million, being approximately 74% of the amount originally claimed.

4.1.2 In the subsequent case of *Moher v HMRC*[32] the Upper Tribunal had held that supplies of the services of agency nurses were standard rated.

4.1.3 HMRC then raised an assessment purporting to recover the amount repaid under VATA 1994 s.80(4A) which provided that:-

> 'Where -
>
> (a) an amount has been credited under subsection (1) or (1A) above to any person at any time on or after 26th May 2005; and

[31] *HMRC v Southern Cross Employment Agency Limited* [2015] UKUT 122 (TCC)
[32] *Sally Moher v HMRC* [2012] STC 1356

(b) the amount so credited exceeded the amount which the Commissioners were liable at that time to credit to that person,

the Commissioners may, to the best of their judgement, assess the excess credited to that person and notify it to him.'

4.1.4 HMRC argued that, even if the Compromise Agreement were valid, this provision gave it power to recover the amount paid. In the alternative, it argued that the agreement it had made had been *ultra vires* as being made under a mistake of law or that no agreement had been made at all. Both the FtT and the Upper Tribunal found against HMRC on all counts.

4.1.5 The idea that HMRC can repudiate its agreements made to settle a matter on a disputed point of law where the uncertainty as to the law is resolved in a subsequent case is startling. As Mr Justice Newey said in the Upper Tribunal:-

' … [HMRC's] submissions on this aspect of the case would, if correct, have far reaching implications.'

According to [HMRC's Counsel] HMRC cannot "settle a case (or make a payment in response to a voluntary disclosure) where they have no liability to the taxpayer". Any agreement between HMRC and a taxpayer could thus, it seems, be reopened if it involved HMRC paying more than proved to be due, regardless of whether the agreement was a reasonable one when it was made.'[33]

[33] *HMRC v Southern Cross Employment Agency Limited* [2015] UKUT 122 (TCC) at para. 53

LADY HENRIETTA PEARSON v HMRC

4.2.1 In *Lady Henrietta Pearson v HMRC,*[34] HMRC simply failed to comply with a prior judgment of the FtT and the unfortunate taxpayer concerned had to take HMRC back to the Tribunal to force it to give effect to that judgment. In that previous Tribunal case,[35] the First-tier Tribunal had decided that Lady Pearson was entitled to a refund of the VAT charged to her in relation to the conversion of a barn into a live-work unit under the Do-It Yourself Builders' Scheme. HMRC had alleged that all the supplies to Lady Pearson were properly standard-rated and that no refund was due.

4.2.2 Having suffered that adverse decision, and having decided not to appeal against it, HMRC did not make the full refund. HMRC asserted that on the basis of the FtT's decision, that Lady Pearson's suppliers should have charged her VAT at the lower rate of 5%. A refund under the DIY Builders' Scheme is properly limited to the VAT which the supplier ought to have charged, so HMRC argued that it need only repay the amount of VAT which would have been charged if the 5% rate had been applied. HMRC advised Lady Pearson to seek repayment of the excess from her suppliers. HMRC was 'regretful' but the suppliers would not be able to recover the excess from HMRC, since the supplies had been more than four years ago.

4.2.3 The result of HMRC's argument, if it had been successful, would have been, therefore, that HMRC made a windfall profit, having received VAT at the full rate on the supplier's outputs, but repaying VAT at a reduced rate on Lady Pearson's inputs. Somebody in

[34] *Lady Henrietta Pearson v HMRC* [2014] UKFTT 890 (TC)
[35] *Lady Henrietta Pearson v HMRC* [2013] UKFTT 332 (TC)

HMRC must have taken a decision that such a result would have been an ethically acceptable result of its litigation.

4.2.4 The Tribunal pointed out that, whilst HMRC was correct in saying that a refund under the DIY Builders' Scheme is only due in respect of the VAT which should have been charged, the FtT had already ruled that HMRC must make the full refund to Lady Pearson of the standard rate VAT which her suppliers had charged her. In its decision at the original hearing the Tribunal had said:-

> 'No issue is taken about the amount of the claim; the only issue we are required to determine is whether the conditions on which a repayment may be made are satisfied.'[36]

4.2.5 It was not, therefore, possible for HMRC to raise a new issue, having had its chance to do so at the original hearing.

4.2.6 The Tribunal in the later application commented:-

> 'Had there been an application to appeal, it would have needed to have been coupled with an application to raise a completely new point that had not been remotely addressed in either the first or second hearings. We rather imagine that the application to appeal would have been dismissed on the basis that just as the suppliers would have been out of time to recover wrongly paid VAT in the amounts

[36] *Henrietta Pearson v HMRC* [2013] UKFTT 332 (TC), para. 2

in excess of 5%, so HMRC would be out of time to raise further points in opposition to the decision of the Tribunal that the appellant had won her appeal to recover £40,233.18.

It seems to us that the situation in the present case is precisely analogous to the situation where an appellant might assert that he is exempt from tax on some particular receipt, and properly appraised there might be two tenable grounds on which HMRC might dispute the claimed exemption. Their proper course is of course to raise both. One may be wrong, and therefore HMRC needs to raise both in the hope that it can win on one or other of the two points. It seems to us that HMRC would never consider the strategy of raising only the one point, making no mention of the second, and then still assert that the tax was owing if the taxpayer had won its appeal.

In the present case, it would have been perfectly possible for HMRC to have raised its primary argument, namely that VAT at the full rate was properly charged and that none of it was recoverable under s.35, but that failing that then if the right rate of VAT payable by the suppliers would have been 5%, then the claim under s.35 would have had to be limited to that amount. Two results of this would have been that the Tribunal would have had to deal with both contentions and the appellant would have known that were she to win on the first point and lose on the second, it might have been prudent to make protective claims for repayment of the balance of the VAT against the suppliers. We have not troubled to consider whether suppliers might then have been in time to make protective claims for recovery from HMRC of wrongly-paid VAT, but this would at least have been a point that would have been clear to the parties a very considerable time before the point was actually raised in this case.

Our decision in this case is accordingly that HMRC have ignored the clear implication of the decision of the Tribunal after the second hearing, namely that the appellant won her appeal which was an appeal to receive her claimed refund of £40,233.18, and it is not in order to refuse a large part of the refund on a basis that HMRC had failed to raise in the concluded appeal.'[37]

[37] *Henrietta Pearson v HMRC* [2014] UKFTT 890 (TC), paras. 12-15

SECTION V

INCOMPETENT

INTRODUCTION

5.1.1 So the decided cases reveal that HMRC's efforts at tax collection are often abusive, its behaviour unconscionable and its word untrustworthy. Perhaps, fortunately for the taxpayer, however, it is also often incompetent. One is often amazed in reading tax reports at the insouciance with which HMRC allows money to be lost to the Public Purse through simple inefficiency.

RYAN GARDINER AND OTHERS v HMRC

5.2.1 *Ryan Gardiner and others v HMRC*[38] is just such a case. The taxpayers had implemented a tax scheme which had failed. HMRC imposed penalties against which the taxpayers appealed. The FtT found that HMRC had not presented evidence showing even a *prima facie* case that the taxpayers had completed their tax returns negligently and so the penalty determinations were set aside.

5.2.2 The scheme which the taxpayers had implemented involved generating capital losses on the acquisition and disposal of capital redemption policies. The taxpayers had disclosed the scheme in their tax returns for 2005/06, which were delivered in January 2007. When an identical scheme was considered and found to have failed in a subsequent case the taxpayers had paid the tax due and the enquiry was closed. HMRC then argued that the

[38] *Ryan Gardiner and others v HMRC* [2015] UKFTT 115 (TC)

returns had been delivered negligently as a result of the incorrect implementation of the scheme and that a penalty was due. The parties agreed that a preliminary issue was whether HMRC had adduced evidence from which the Tribunal could prima facie be satisfied that the taxpayers had negligently delivered incorrect tax returns. HMRC contended that the taxpayers had signed documents which were either not authentic or misrepresented the reality of what had taken place.

5.2.3 The FtT pointed out that the documents concerned had been unilateral documents signed only by the promoter of the scheme. The allegation in HMRC's statement of case was to the effect that 'a reasonable person, having examined the documentation would have realised that the scheme had not been properly implemented'. The FtT observed that the allegation of negligence should have been particularised and HMRC had failed to establish a *prima facie* case of negligence. It seems that HMRC called no witnesses and was unable to produce in evidence any of the documents on which it sought to rely.

5.2.4 Berg Kaprow Lewis were quoted in the *Tax Journal* of 23rd May as commenting that, if the taxpayers had in fact been negligent, HMRC's handling of the case would have allowed the taxpayers to escape a penalty for it. If they were not actually guilty of negligence, their time and money has been wasted in resisting an entirely unsubstantiated allegation.

HMRC v MCCARTHY & STONE (DEVELOPMENTS) LTD AND ANOTHER

5.3.1 In *HMRC v McCarthy & Stone (Developments) Ltd and another*[39] the chance to collect £2.8m of VAT and interest was lost due to simple incompetence by HMRC.

5.3.2 In this case the taxpayer companies had won their appeal to the FtT, which had allowed deductions of input tax relating to the costs of furnishing communal areas of retirement apartments built and sold by the taxpayers.

5.3.3 HMRC's notice of appeal to the Upper Tribunal was 56 days late due to its administrative errors. They applied for an extension of time under the Tribunal Procedure (Upper Tribunal) Rules, SI 2008/2698.

5.3.4 The Upper Tribunal dismissed HMRC's application. It considered the meaning of new rule 3.9 of the Civil Procedure Rules, SI 1998/3132, which applied from 1st April 2013. Although those rules did not apply to tribunals, the Tribunal held that it should not adopt a more relaxed approach than that to which the Courts were subject.

5.3.5 HMRC submitted that it would be unfair and unjust for it to be prevented from pursuing the appeal because their delay was relatively short and resulted from an unintentional error. The deadline for the appeal was one month and the Revenue's appeal was 56 days late. That is they delayed submitting their appeal for almost double the period which they were given for making that appeal. HMRC obviously has a different view of what is a relatively short delay to that of most people.

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39 *HMRC v McCarthy & Stone (Developments) Ltd and another* [2014] UKUT 0196 (TCC)

5.3.6 HMRC was not only unable to give a good reason for their failure to serve the notice of appeal on the Upper Tribunal within the time limit, they were unable to give any explanation at all. The Tribunal found that, in the circumstances, it would not be consistent with the need to ensure that appeals in the Upper Tribunal were conducted efficiently to allow HMRC to serve a notice of appeal almost two months after the time limit had expired.

5.3.7 In more detail, the relevant facts were as follows.

5.3.8 The substantive matter at issue was the deductibility of input tax on the furnishings of communal areas in retirement accommodation. The appeal on that issue turned on whether there was a single zero-rated supply of residential accommodation as the taxpayer asserted or a single supply with a zero-rated accommodation element and an exempt element (the use of the communal area furniture). The FtT found in the taxpayer's favour and HMRC attempted to appeal, late, to the Upper Tribunal.

5.3.9 McCarthy & Stone, when the time limit for HMRC's appeal expired, made an adjustment to its group management accounts to show the full amount of the disputed VAT input tax was due to McCarthy & Stone and an update to their forecast financial position on that basis. This formed the basis of a term sheet which McCarthy & Stone issued to key lenders and shareholders with a view to the negotiation of a fundamental restructuring and refinancing of its debt. After the group management accounts had been approved by the board and sent to lenders and shareholders an HMRC Officer, Mr Belbin, sent an email to the company referring to a part of McCarthy & Stone's claim as being 'subject to the appeal process'. The company then telephoned Belbin to say that they understood that there was no appeal to the Upper Tribunal and Belbin immediately contacted HMRC's solicitor's office.

5.3.10 The Upper Tribunal's judgment records that Counsel for HMRC:-

> '" … submitted that, applying the overriding objective, it would be unfair and unjust for HMRC to be prevented from pursuing this appeal because of a relatively short delay, of just under two months, resulting from an unintentional error of the kind that occurred. [He went on to say] … that courts have viewed applications for extensions of two months or less as fundamentally different, in terms of fairness, from applications for much longer extensions and referred me to the comments … in *Smith v Brough* [2005] EWCA Civ 261, … . I do not regard those comments as laying down any rule that a delay of two months should be regarded as fundamentally different from a longer delay. The length of the delay is a matter that must be taken into consideration along with the other circumstances of a case. In some circumstances, perhaps where potential prejudice to a party is both obvious and great, a much shorter delay than two months would be considered to be unfair.
>
> …
>
> An informal and flexible approach may mean that a self-represented litigant is granted relief from a failure to comply with the rules, including time limits, in circumstances where a more experienced and better resourced party is not. That difference in treatment between different parties does not mean that the UT is applying dual standards but only that the level of experience and resources of a party are factors which should be taken into account in considering all the

circumstances of the case. Such factors will, however, carry less weight than the two principal matters which must be considered in the new CPR 3.9." '[40]

5.3.11 It appears that there were multiple failures by HMRC's staff which, if any one had not occurred, would have led to them submitting the appeal within time:-

'Unlike the example given by the court in *Mitchell*, this was not a case where, because of overwork or other reason, a solicitor simply overlooked a deadline which the court stated would be unlikely to be a good reason to grant an extension of time. In this case, Mr Stok and Mr Coleman received the notification of the grant of permission to appeal and, it appears, did not inform others of it when, for different reasons, they stopped working at the Solicitor's Office. Mr Williams and Mr Beresford missed the FtT's email with the decision granting permission to appeal when reviewing Mr Stok's files after he had gone on long term sick leave. Although I accept that it is easy to overlook one email among so many, I consider that the fact that this one was missed shows that this appeal was not being efficiently managed after Mr Stok's departure. There was no evidence that Mr Stok had not maintained the file relating to the appeal properly. It should have been clear from looking at the case file that an application to appeal had been made to the FtT on 8 February. A decision from the FtT should have been expected within a few weeks (certainly before the date of Mr Stok's departure) and a simple search of Mr Stok's inbox would have discovered the email which had the name and reference of the appeal in its subject line. The evidence shows that, despite it being an active matter, Mr Williams did not review the file for this appeal until prompted to do so by Mr

[40] *HMRC v McCarthy & Stone (Developments) Ltd and another* [2014] UKUT 0196 (TCC), paras. 39 & 44

Belbin's telephone call on 28 June. I conclude that, between 12 April and 28 June, this appeal was not being conducted efficiently.

The fact that the appeal was not being conducted efficiently does not inevitably lead to the conclusion that HMRC's application must be refused. In particular, if there is a good reason for the conduct then this factor would weigh less heavily against HMRC. The burden is on HMRC to satisfy me that there was a good reason for the time limit not being met. HMRC's frank admission that they made an administrative error is commendable but does not provide any explanation for the failure to comply with the time limit. Although Mr Stok went on long term sick leave from 12 April, HMRC expressly disclaimed any reliance on his illness either before or after his absence as a reason for the failure. I think that is right. HMRC Solicitor's Office has many lawyers and paralegals and should be able to handle cases in the event that a lawyer falls ill or leaves. No reason was given why Mr Williams' review of Mr Stok's active case files and email account did not reveal that the FtT's decision granting permission to appeal had been received. In short, HMRC are not only unable to give a good reason for the failure to serve the notice of appeal on the UT within one month, they are unable to give any explanation at all. It seems to me that, in the circumstances of this appeal, it would not be consistent with the need to ensure that appeals in the UT are conducted efficiently to allow HMRC to serve a notice of appeal almost two months after the time limit has expired.

The need to enforce compliance with the UT Rules

In *Mitchell*, the Court of Appeal stated ([2014] 1 WLR 795 at [48]):

“… we consider that well-intentioned incompetence, for which there is no good reason, should not usually attract relief from a sanction unless the default is trivial” …

The failure by HMRC Solicitor’s Office to provide the notice of appeal for a period of 56 days after the time limit for doing so had expired was neither minor nor trivial. The service of the notice of appeal on the UT, which then sends it to the respondent, is an important part of the appeal process without which further progress is impossible. The fact that a failure to comply with a time limit is neither minor nor trivial does not preclude the UT from extending time in order to enable the party to comply if there was a good reason for the default and it is fair and just to do so in all the circumstances of the case. As discussed above, HMRC have not advanced any reason for the failure to comply with the UT Rules other than administrative error which I equate with the ”‘well-intentioned incompetence” mentioned in *Mitchell*. As in that case, I find that the administrative error that led to a breach of the UT Rules was neither minor nor trivial. Refusing applications to extend time limits made after they have expired reinforces the need for parties to comply with the time limits in the UT Rules and directions made under them. In the absence of any good reason for failing to comply with the time limit, I can find no reason, in the circumstances of this case, not to apply the sanction provided by r.23(5)(b) of the UT Rules and refuse to admit HMRC’s notice of appeal.’[41]

[41] *HMRC v McCarthy & Stone (Developments) Ltd and another* [2014] UKUT 0196 (TCC), paras. 49 – 52

5.3.12 In respect of HMRC's attitude to time limits generally, the Judge did say:-

> '*The extent to which HMRC has complied with other rules*
>
> As the appeal had barely started, this factor is not relevant in relation to these particular proceedings. If a broader perspective is relevant, my own experience is that HMRC do not deliberately or persistently disregard time limits or other provisions of the UT rules. I would, of course, not expect HMRC to engage in such conduct and this factor does not carry much weight in favour of granting HMRC's application.'[42]

5.3.13 Whether that corresponds to readers' experiences generally, one doubts.

BRISTOL AND WEST PLC V HMRC

5.4.1 *Bristol & West Plc v HMRC*[43] was an Upper Tribunal case in which HMRC combined incompetence with dishonesty to a startling degree. In the case, HMRC's amendment to the taxpaying company's return was rejected in its entirety by the Upper Tribunal due to a simple error by an HMRC official, resulting in the loss of £9.2m in tax. The error was compounded by a lackadaisical failure to take a basic step which would have prevented the loss. One can see that HMRC would be embarrassed by such a mistake, but I was astonished at its effrontery in publishing a press release on the case boasting about the taxpayer's defeat and claiming for HMRC a notable victory.

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[42] *HMRC v McCarthy & Stone (Developments) Ltd and another* [2014] UKUT 0196 (TCC), para. 56
[43] *Bristol & West Plc v HMRC* [2014] UKUT 0073 (TCC)

5.4.2 The case concerned a tax avoidance scheme implemented by the Bristol & West Group in 2003. The Upper Tribunal found that the scheme failed on a close construction of the legislation but because the HMRC official responsible for raising a Closure Notice had issued a Notice stating a conclusion which did not indicate that an amendment was required to the taxpayer's return, the return could not be amended.

5.4.3 Because of the nature of the receipt at issue, £30.6m fell to be assessed in the year under appeal and £60m in later years. Having won on the substantive issue, it may be that HMRC will collect tax on the latter amount but the Corporation Tax of £9.2m on the £30.6m of income which was actually at issue in the appeal has been lost to the Exchequer.

5.4.4 Having issued the incorrect Closure Notices the Upper Tribunal noted that it would have been:-

> '... possible for [the HMRC official concerned] to go and rummage through all the Closure Notices in their envelopes that were still in HMRC's clutches on 31st October 2007 but I assume that task was so large it was not considered worth doing. As my decision will show had they stopped that Closure Notice being sent out none of the problems would have ensued.'[44]

5.4.5 £9.2m of tax would surely have paid for sufficient staff time to make the 'rummage' 'worth doing'.

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[44] *Bristol & West plc v HMRC* [2014] UKUT 0073 (TCC), para.27

The Significance of the Case

5.4.6 It does not appear that the Tribunal's acceptance of HMRC's arguments on the substantive issue was of great significance in respect of other taxpayers. The planning exploited transitional provisions which ceased to apply shortly after the transactions at issue in the case. HMRC said in a 'News Story' which was published on the 20th February 2014 that:-

> 'A further £215 million was protected when other followers of the plan settled before being taken to [sic] tribunal.'

5.4.7 If these 'followers' had settled before the Upper Tribunal hearing, however, then the decision in that hearing cannot have been the trigger to their decision to settle. Significantly, what the 'News Story' did not claim was that there were outstanding unresolved cases in respect of similar transactions.

5.4.8 So it would seem that the net result of the case, unless it is overturned on appeal,[45] is that the assessment on Bristol & West was dismissed in its entirety with a loss of tax of £9.2m, even though the planning failed technically. Although Bristol & West may have to pay tax on the receipt apportioned to future years, nothing indicates that the Upper Tribunal's decision has had any effect in prompting 'followers' to settle.

Disciplinary Procedures?

5.4.9 It seems unlikely that a private sector organisation would suffer a loss of this magnitude resulting from a failure of a member of its staff without instituting some form of disciplinary procedure. We telephoned HMRC's Press Office to ask whether any disciplinary action

[45] Both parties have appealed to the Court of Appeal

had been taken in respect of any of HMRC's staff in connection with the case. At first we were told that HMRC would not comment. Two days later we received an email which said:-

'... below is all we are saying about this Judgment:-

"We frequently review our processes and procedures to ensure that closure notices are only issued in appropriate circumstances."

Kind regards ...'

Misinformation

5.4.10 When the decision was published HMRC issued a press release with a banner headline 'Bristol & West Tax Avoidance Plan Loses Again'. The opening paragraph of the press release said:-

'Bristol & West Plc, owned by Bank of Ireland, has lost its second attempt to avoid £27 million of corporation tax by claiming that there was a loophole in the law governing the taxation of derivatives.'

5.4.10 The £27 million referred to appears to be Corporation Tax at 30% on the total receipt of £91m. It thus fails to reflect the £9.2m lost through HMRC's blunder.

5.4.11 The press Release went on to quote David Gauke, Exchequer Secretary to the Treasury, as saying:-

> 'This case is the result of HMRC's relentless work against a highly complex and speculative avoidance gamble that, unchallenged, would have deprived the country of over £27m in corporation tax.'

5.4.12 Only in a note to editors near the end of the press release did it refer to the fact that:-

> 'The Upper Tribunal allowed Bristol & West's appeal on the point that was originally upheld in ... HMRC's favour in the First-tier Tribunal, involving a closure notice mistakenly sent out.'

5.4.13 What the note did not say is that, because of this error, the Tribunal's decision was entirely in Bristol &West's favour, that the Tribunal entirely rejected the amendment made by HMRC to Bristol & West's return and that £9.2m of tax was not chargeable which would have been chargeable under the Tribunal's view of the substantive issue had the error not been made. This misleading information was repeated in an HMRC 'news story' released on the same day which still appears on the Government's website at the time of writing. Over two months later, HMRC's Agent Update 41 continued to give the same, misleading, view of the case.

Information or Propaganda?

5.4.14 Do you, like me, find the publication of misleading information by HMRC, presumably with the consent of Mr Gauke, deeply disturbing? This was not a one-off mistake. The material was published by the Government in at least three separate forms over a period of two months. It was repeated, uncritically, by parts of the technical press and HMRC took no steps to correct the misapprehension it had created. In the light of this behaviour can one really trust material published by HMRC to meet the most basic standards of accuracy and honesty?

McKie&Co

SECTION VI

CONCLUSION

VALUABLE IF NOT VALUED

6.1.1 When one considers the nature of HMRC's behaviour revealed in the case reports it is clear that we, as tax advisers, have an important role to play in protecting taxpayers from the excesses of a department the behaviour of which is no longer controlled effectively by Ministers.