Tax update

April 2016

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FII Group Litigation: High Court grants summary judgment against HMRC

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Any comments or queries

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About this update

The Tax update is published on the first Thursday of every month, and is written by members of RPC's Tax Dispute team.

We also publish a general VAT update on the final Thursday of every month, and a weekly blog, RPC Tax Take.

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News

Automatic exchange of information: draft regulations and guidance published

On 1 February 2016, HMRC took the unusual step of publishing draft regulations through the CIOT (rather than its own) website. The International Tax Compliance (Client Notification) Regulations 2016 and associated draft guidance deal with the client notification requirements referred to in section 222(2)(c), Finance Act 2013. The regulations will require certain financial institutions and "specified relevant persons" (which could include tax advisers/accountants/ lawyers) who have provided offshore advice to clients to write to those clients about the impact of the Common Reporting Standard (CRS) before 30 April 2017. Specifically, advisers are to warn their clients that HMRC will soon be obtaining data on overseas financial accounts; that there are opportunities to make disclosures; and, of the potential danger of penalties (including proposed criminal offences) for non-compliance.

HMRC has said that it will provide standard wording for such notifications.

The consultation period was due to close on 12 February 2016. The Bar Council raised concerns over the broad scope and burdensome nature of the requirements. Others have complained about the costs of compliance and the proposed sanctions for non-compliance.

The intention was for the regulations to come into effect from 6 April 2016, however, the consultation period has been extended to 22 April 2016. The draft regulations and guidance appear to have been removed from the CIOT's website.

The Bar Council's summary of the proposals is available to view here.

Any comments on the proposals should be sent to technical@ciot.org.uk.

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Deemed domicile: draft legislation published

HMRC has published draft legislation, to be included in Finance Bill 2016, regarding the rules on deemed domicile. The new rules will apply to persons born in the UK, with a UK domicile of origin who are resident in the UK, or where a non-UK domiciled person has been resident for 15 out of the previous 20 tax years. The changes are due to have effect from 6 April 2017.

Concerns have been expressed that this legislation will be enacted before the scope of any exceptions, in particular, in relation to offshore trusts, have become clear, leading to a period of uncertainty for those affected.

The draft legislation is available to view here.

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Small company taxation: review published by the OTS

The Office of Tax Simplification has published its review of small company taxation.

The intention of the review is to highlight areas where tax can be made simpler for companies with fewer than 10 employees.

The proposals include cash accounting for small companies; liability protection for sole traders to remove some of the need for incorporation; and taxation of shareholders as an alternative to corporation tax for certain business types.

In addition, the review considers aspects of the UK's tax system which create particular practical difficulties for small businesses, such as arbitrary differences in filing and payment dates for VAT, PAYE, corporation tax and Companies House filing requirements. It includes innovative suggestions for a turnover basis or cash basis for taxation.

The OTS review is available to view here.

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BPP Holdings v HMRC: Court of Appeal unimpressed by HMRC's Austerity Plea

The following is based on an article first published in Tax Journal on 8 March 2016.

BPP Holdings v HMRC [2016] EWCA Civ 121, is primarily a case concerning the extent to which HMRC must comply with directions issued by the First-tier Tribunal (FTT).

Background

BPP Holdings (BPP) had applied to the FTT to have HMRC debarred from further participation in its appeal under Rule 8 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Tribunal Rules), on the ground that HMRC had failed to comply with a direction issued by the FTT that it file further and better particulars of its case by a specified date. HMRC failed to comply with that direction.

Before the FTT (Judge Mosedale), BPP was successful and HMRC was debarred from further participation in the proceedings that were before it. HMRC successfully appealed to the Upper Tribunal (UT) (Judge Bishopp) and BPP appealed the UT's decision to the Court of Appeal.

The critical difference between the decisions of the FTT and UT was the release of the conflicting decisions in *McCarthy & Stone (Developments) Ltd v HMRC* [2014] UKUT 197 (TCC) [2014] STC 973 (which the FTT had the benefit of) and *Leeds City Council v HMRC* [2014] UKUT 350 (TCC), which had been decided by Judge Bishopp and had been released when the UT was sitting in *BPP*. Both cases considered whether the stricter approach to compliance with rules and directions made under the Civil Procedure Rules (CPR) as set out in *Mitchell v News Group Newspapers Ltd* [2014] 1 WLR 795 and *Denton v TH White Ltd* [2014] 1 WLR 3296, applies to cases before the tax tribunals. In *McCarthy*, the UT concluded that the stricter approach applies to cases before the tax tribunals whereas in the *Leeds City Council* case, the UT concluded that as the Tribunal Rules were less strict than the CPR, *Mitchell* and *Denton* did not apply to litigation before the tax tribunals.

Court of Appeal decision
Before the Court of Appeal, HMRC argued that the approach adopted by the UT in *Leeds City Council* should be preferred. HMRC appeared to argue that, as a state agency during a time of austerity, the Court should subject it to a lower standard – perhaps that of a litigant in person. This suggestion was roundly rejected by the Court of Appeal, commenting that it found HMRC's approach to compliance to be "disturbing" and that even a litigant in person is expected to comply with the rules of court and court orders. The Court said that "a State party should neither expect to nor work on the basis that it has some preferred status". The Court had little difficulty in allowing BPP's appeal.

The *BPP* case, in effect, endorses the stricter approach adopted by the UT in *McCarthy* to compliance with rules and directions and in effect overturns *Leeds City Council*.

Significantly, the decision in *Peter Nichols and Ano v HMRC* (TC/2015/04557 and TC/2015/04618), handed down on 4 March 2016, is the first indication since *BPP* of the FTT's approach to failure on the part of HMRC to comply with instructions issued by the FTT. The taxpayers' applications to the FTT for closure notices were resisted by HMRC, who first attempted to postpone the hearing and then filed witness statements the night before the hearing and a substantial bundle of documents shortly before 10.30 on the morning of the hearing itself (it had been ordered to do so no later than 14 days before the hearing).

In its defence, HMRC argued that it considered the application for a closure notice to be a "satellite" affair to its enquiry. The FTT (Judge Brooks) was not impressed and described this "cavalier approach" as "simply not good enough". Commenting on the *BPP* decision, the FTT refused to admit HMRC's evidence and directed HMRC to issue closure notices by the end of May 2016.

Comment
The decisions of the Court of Appeal in *BPP* and the FTT in *Nichols*, are to be welcomed. Although the tax tribunals are less formal than the higher courts, the Tribunal Rules and directions issued by the tax tribunals must be complied with and cannot be ignored.

The *BPP* decision is available to view here.

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Sanderson v HMRC – discovery assessments and the "hypothetical officer"

The following is based on an article first published in Tax Journal on 26 February 2016.

In its decision in *David Stephen Sanderson v HMRC* [2016] EWCA Civ 19, the Court of Appeal dismissed Mr Sanderson's appeal against decisions of the FTT and UT and confirmed that HMRC was able to make use of the discovery assessment provisions, contained in section 29 TMA 1970, in order to assess him to tax where the officer could not reasonably be expected to know there was an insufficiency of tax even where details of the pre-DOTAS scheme were disclosed in the relevant tax return.

Background
Mr Sanderson was issued with a discovery assessment pursuant to section 29 TMA 1970 in relation to capital gains tax which arose in 1998-99, as a result of his participation in a tax planning scheme (the Scheme). The Scheme, which attempted to create capital losses, was successfully challenged by HMRC and failed to achieve the intended fiscal consequences.

Between 1999 and 2007, a specialist HMRC team consisting of members of Special Compliance Office (SCO) and Special Investigation Section carried out an in-depth investigation into the Scheme. In the days before the disclosure of tax avoidance schemes (DOTAS) regime, HMRC was obliged to identify taxpayers who had participated in the Scheme through a manual review of all tax returns which had been submitted to it in respect of the years concerned in which more than £200,000 had been claimed as a capital loss.

In July 1999, the Office of Supervision of Solicitors (OSS) provided a list to SCO, containing the names and addresses of individuals who had paid to acquire losses through the Scheme. The list included Mr Sanderson's details. This information was recorded on an HMRC database consisting of individuals who were under investigation by SCO.

SCO proceeded to obtain Mr Sanderson's file from his district tax office and reviewed it. Following this review, the file was returned to the district office, SCO noting that Mr Sanderson had failed to lodge his 1997-98 and 1998-99 tax returns. SCO requested that the returns be sent to them when they were received by the district office. This failed to happen.

Mr Sanderson's tax return for 1998-99, due to be filed with HMRC by 31 January 2000, was eventually received by HMRC on 24 February 2003. This gave HMRC 14 months from receipt to issue an assessment to tax under the normal time limits.

In his return, in the "white space" further information section, Mr Sanderson gave a clear indication of the source of the losses and the name of the relevant trust. His return was not sent to SCO as had been requested and no formal enquiry was opened or assessment issued. HMRC admitted, during the hearings below, that if it had searched for Mr Sanderson's file he would have been subjected to an enquiry under section 9A TMA 1970, within the relevant statutory time period.

In the meantime, HMRC issued a closure notice against the trustees of the Scheme in November 2003, which reduced the £1bn loss claim, which had been submitted by them, to nil. SCO then wrote to all of the taxpayers connected to the Scheme, including Mr Sanderson, indicating the terms of a settlement offer. However, no enquiry had been opened into Mr Sanderson's return and he did not respond to this offer. Finally, in January 2005, 12 months later and two years after submitting his return, HMRC made its purported "discovery" and issued a discovery assessment to Mr Sanderson. Mr Sanderson challenged the validity of the discovery assessment and appealed to the FTT. He was unsuccessful both before the FTT and on appeal before the UT. He appealed to the Court of Appeal.

Court of Appeal decision

By the time the matter reached the Court of Appeal, the issue was whether the second condition imposed by section 29(5) TMA 1970 for the exercise by HMRC of the power to issue a discovery assessment had been satisfied. So far as relevant, section 29 provided at the relevant time as follows:

> *"(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment –*
>
> *(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or*

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

(c) that any relief which has been given is or has become excessive,

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

...

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

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

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

unless one of the two conditions mentioned below is fulfilled.

...

(5) *The second condition is that at the time when an officer of the Board —*

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or

(b) informed the taxpayer that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above."

In order to determine what could be reasonably expected, the courts have deemed the analysis to centre on a "hypothetical" rather than actual officer, of general competence, knowledge or skill (*HMRC v Lansdowne Partners LLP* [*2012*] STC 544).

In determining what it was reasonable for the officer to know, the Court of Appeal construed the bounds of relevant information narrowly. Mr Sanderson's file had been obtained by SCO, and they had asked for Mr Sanderson's tax return to be sent to them once received by his district tax office. Further, SCO had written to Mr Sanderson regarding the settlement opportunity. In addition, Mr Sanderson had made the following extensive disclosure in his return:

European average rate option (Trade No. 82831)

I am entitled to the loss of £1,825,663 by virtue of the provisions of TCGA 1992 s.71(2). The loss is part of a loss of £1,000,000,000, which accrued to the Trustees of the Castle Trust on 8th April 1997, on the disposal of a European Average rate Option (Trade No. 82831) relating to shares in Deutsche Telecom.

Beneficial interest in the Castle Trust

On 24th November 1998, I purchased for a fee (part of which is contingently payable) from the Trustees of the Charter Trust 2.273% of their beneficial interest in the Trust Fund of the Castle Trust. The interest determined on 25th November 1998, when I became absolutely entitled to receive from the Trustees of the Castle Trust the sum of £16.04."

In order to ascertain whether there was sufficient information available to HMRC, the test is whether there was enough information available for the officer to decide to raise an assessment. HMRC argued, and the Court of Appeal accepted, that it was not enough for the disclosure made by the taxpayer to simply cause an officer to ask further questions. The officer must "be made aware of an actual insufficiency" of tax (*Langham v Veltema* [2004] STC 544).

Mr Sanderson argued, following the logic in *Charlton v HMRC* [2013] STC 866, that the information contained in the disclosure which was contained in his return would have been sufficient for the hypothetical officer to infer that he was one of a number of individuals participating in a tax avoidance scheme. This, however, was rejected by the Court on the basis that unlike in *Charlton* where the disclosure of the Scheme Reference Number would mean that a form AAG1, containing full details of the scheme, had been provided to HMRC by the scheme promoter, there was no such number or form in this case.

The Court concluded that it would have been "entirely speculative" for the hypothetical officer to conclude that another part of HMRC may have information on the Scheme. Mr Sanderson's appeal was therefore dismissed.

Comment

The unusual facts of *Sanderson* may be sufficient to render it a peculiarity, as similar arrangements would now be notifiable under the DOTAS regime and in such circumstances the taxpayer would be able to rely upon the *Charlton* decision to prevent HMRC from issuing a discovery assessment. However, this is the latest in a number of recent discovery cases in which the courts have attributed to the hypothetical officer very little knowledge, notwithstanding extensive information having been made available to HMRC.

In this instance, Mr Sanderson had provided details of the Scheme in his tax return. His name was included on a list of people who had participated in the Scheme which had been supplied to SCO in 1999. His file was located and obtained by SCO, who issued instructions that his tax return should be forwarded to them on receipt by the district. Given this background, one would have thought the hypothetical officer could reasonably be expected to have been aware that there were chargeable gains which ought to have been assessed to capital gains tax.

In dismissing Mr Sanderson's appeal, the Court of Appeal has further eroded the level of knowledge which may be imputed to the "hypothetical officer". It would appear that disclosing details of a tax avoidance scheme is not, of itself, sufficient to prevent HMRC making a discovery

assessment pursuant to section 29 TMA 1970. In addition, taxpayers cannot assume that the hypothetical officer will be deemed to be aware of information held by others within HMRC.

The "discovery" in this case appears to have been the realisation by HMRC that due to an oversight on its part, the investigation into Mr Sanderson had not been pursued. Without the decision in *Charlton* (which was expressly endorsement by the Court of Appeal), HMRC would no doubt seek to argue in similar circumstances that the disclosure of a Scheme Reference Number would be insufficient to prevent it from issuing a discovery assessment. Were it to be successful with such an argument, section 29 would be rendered all but meaningless.

The *Sanderson* decision is available to view here.

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FII Group Litigation: High Court grants summary judgment against HMRC

In the recent case of *Evonik Degussa UK Holdings Ltd and Others v HMRC* [2016] EWHC 86 (Ch), the High Court granted a number of claimants summary judgment in relation to part of their claims in the Franked Investment Income Group Litigation (FII Group Litigation). The Court allowed the applications on the basis that: (1) the law in relation to the payment of advance corporation tax (ACT) on foreign income dividends (FIDs) had been settled in *FII (High Court) II* [2014] EWHC 4302, and HMRC had no real prospect of success of arguing against that decision; (2) the CPR allowed for part of the claimants' claims to be summarily determined; and (3) although the claimants' applications for summary judgment had been made prematurely, HMRC had not objected at the appropriate time and had therefore waived its right to object.

Background

This judgment is the latest instalment in the long-running FII Group Litigation which began in 2003.

The claimant companies all belong to groups with UK resident parents with overseas subsidiaries resident elsewhere in the European Union (EU) and in third countries. Broadly, the FII Group Litigation concerns the lawfulness, under EU law, of UK rules which:

- imposed corporation tax on dividends received by UK parent companies from subsidiaries resident in other EU member states, and (in some contexts) from subsidiaries resident in third countries (Schedule D Case V)
- imposed ACT on dividends paid by a UK resident company which had received dividends from companies resident in other member states, but did not impose ACT on dividends paid by a UK resident company which had received dividends from UK resident companies
- introduced the FIDs regime obliging UK resident companies to pay (and subsequently reclaim), the ACT in respect of a FID.

The claimants claimed:

- restitution of the unlawfully levied Schedule D Case V tax
- restitution of the unlawfully levied and unutilised ACT
- interest on the unlawfully levied but utilised ACT (from the date of payment to utilisation)
- interest on the above amounts from the date of payment (or utilisation) until repayment.

The European Court of Justice (ECJ) gave its first judgment in the FII Group Litigation on 12 December 2006, confirming the following:

- Schedule D Case V was only compatible with the EU treaty if the domestic tax rate charged on EU dividends was no higher than the rate applied to domestic dividends and a tax credit is granted that is at least equal to the tax paid in the distributing stage
- the ACT regime was unlawful so far as it applied to EU dividends
- the FID regime was unlawful so far as it applied to both EU and third party dividends.

Since 2006, the progress of the FII Group Litigation has been long and winding, with the High Court giving a judgment in November 2008; the Court of Appeal in February 2010; the Supreme Court in May 2012 and the ECJ providing two further judgments in November 2012 and December 2013.

The litigation then returned to the High Court for rulings on issues of quantification. The High Court delivered its judgment in *FII (High Court) II* [2014] 4302, on 18 December 2014.

Facts

In the instant case, seven groups of claimants who were enrolled in the FII Group Litigation issued applications for summary judgment against HMRC under CPR 24.2, or alternatively interim payments in respect of their claims for restitution of ACT paid in respect of the FIDs. Their claims related to the period from 1 July 1994, when the FID regime was introduced in the UK, to 5 April 1999, when ACT was abolished.

The claimants' applications were heard by Mr Justice Henderson.

High Court decision

The judge considered the following three questions:

1. **Has the unlawfulness under EU law of the ACT paid by the claimants on their FIDs been established so clearly that there is no real prospect of HMRC successfully defending their claims for restitution of that ACT and its time value?**
   This was the central question to be answered in determining the applications. HMRC submitted that the answer to the above question was in the negative on the basis that there was still a prospect that the Court of Appeal would grant it permission to appeal on the FID issues when its application for permission was renewed at a forthcoming appeal hearing, and that the Court of Appeal (or, on further appeal, the Supreme Court) would take a different view of the law from that taken by Henderson J in *FII (High Court) II* [2014] 4302. The judge asked himself whether the law in relation to the payment of ACT on FIDs had been settled. In his view, there was no reason to depart from the conclusions he had reached in *FII (High Court) II* [2014] 4302 in relation to the FID claims and he did not consider that HMRC's arguments to the contrary had any real prospect of success.
2. **Is summary judgment available to the claimants even if they do not seek judgment on either the whole of their claim or on a particular issue, but rather on part of their overall claim for restitution?**
   This was the first of two "technical" objections raised by HMRC as to why the claimants should not be granted summary judgment. This was based on the wording of CPR 24.1 and 24.2 which HMRC argued precluded such an application. The judge disagreed with HMRC stating that the position is "put beyond reasonable doubt" because Practice Direction 24 provides that the word "claim" includes a part of a claim. The judge said that he found

HMRC's submission a "startling one" and that such a restriction would serve no conceivable purpose and would be "contrary to the overriding objective, and would be a trap for the unwary".

3. **Were the claimants' applications made prematurely because the claimants did not apply for the stay imposed on their claims by the FII Group Litigation Order to be lifted either before or when they made their applications?**
   This was the second technical objection raised by HMRC. In the judge's view, HMRC must have been aware earlier of its right to object to the claimants' applications on this ground, but it had refrained from asserting this right either at a previous case management conference or when the applications were listed for trial. A waiver or acquiescence was therefore established and also arguably a promissory estoppel. The judge commented, at paragraph 80, that "if there was no reasonable prospect of a defence to the whole or part of the FID ACT claims, considerations of fairness and justice dictate that the claimants should be able to obtain an effective remedy at the earliest convenient opportunity, without being made to wait several more years until the FII Group Litigation has finally reached its conclusion".

The Court granted summary judgment to the claimants, except in relation to:

- claims for restitution in the form of compound interest, for the periods after utilisation or repayment of the relevant ACT because the Supreme Court had granted HMRC leave to appeal in relation to this issue
- part of one of the claimant's claims which was subject to proceedings before the FTT.

Comment

Given that the value of the claims (including compound interest) totalled approximately £207 million, it is perhaps not surprising that HMRC strongly resisted the claimants' applications. It is interesting to note that the Court was informed that the reason the claimants did not formally apply for the stay to be lifted was due to their apprehension that, if given notice of their intention to apply for summary judgment, HMRC might take immediate steps to prevent them from obtaining the benefit of judgment in their favour, whether by procuring the enactment of fresh legalisation or otherwise. The judge commented that "experience has shown that such fears are by no means fanciful" (see paragraph 70 of the judgment).

The *Evonik* decision is available to view here.

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