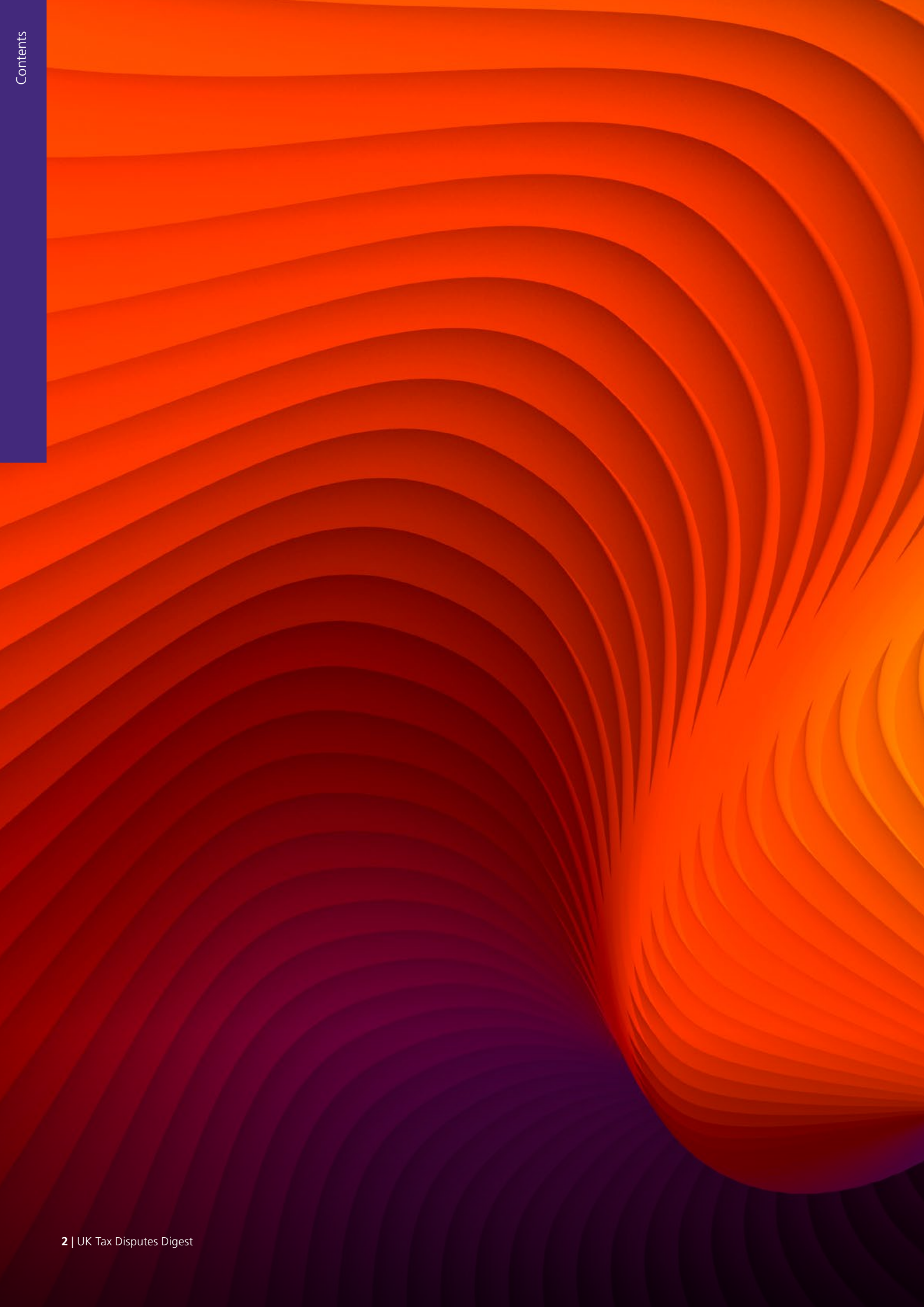
UK Tax Disputes Digest

August 2022



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Introduction

Welcome to the summer (and very first) edition of our UK Tax Disputes Digest: a high-level summary for general counsel, heads of tax and other in-house professionals of some of the key tax cases over the last few months, together with our pick of the more interesting procedural decisions from the tax tribunals and the potential implications for taxpayers.

We also refer to some of the other key developments in UK tax disputes and investigations, including HMRC's first use of new powers to publicly name tax avoidance schemes and their promoters, as well as the latest series of nudge campaigns.

About the team

With 15 partners in our London office, the CMS tax team is one of the largest in the City and advises high-profile clients across a wide range of sectors and all areas of tax. As part of that general tax practice (and the CMS global network with tax capability in over 70 offices), our tax team regularly helps both individuals and corporates with all aspects of tax dispute prevention, management and resolution.

The CMS disputes team is one of the UK's leading contentious practices with some 500 disputes lawyers in the UK alone. We regularly appear before all courts and have more sector and practice expertise among our disputes lawyers than any other firm. We are one of only a few firms to routinely appear in The Lawyer's annual reports on leading cases both for first instance and appeal cases.

The firm's contentious tax practice pools the resources of the CMS tax and disputes teams, including dedicated tax disputes specialists.

For more information on our team and the type of work we undertake, please see here

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With thanks also to Elizabeth Sherwood, Hannah Jones, Alex Oldland, Phoebe Puttock, Tommi Barnes and Filip Rynkiewicz for their contributions.

In Focus: transfer pricing and unallowable purpose

In *HMRC v BlackRock Holdco 5 LLC* [2022] UKUT 199 (TCC), the key issues of transfer pricing and unallowable purpose came under the spotlight, with HMRC securing an important win against the taxpayer.

Background

This case relates to BlackRock's 2009 acquisition of the North American investment management business of Barclays Global Investors ("**BGI**"). The acquisition structure involved three Delaware LLCs: LLC 4 (US tax resident); LLC 5 (UK tax resident); and LLC 6 (US tax resident). LLC 4 advanced debt to LLC 5, receiving loan notes of $4 billion in LLC 5. LLC 5 used the debt to subscribe for preference shares in LLC 6, which acquired the BGI business.

The First-tier Tribunal (Tax Chamber) ("**FTT**") had found that LLC 5 had been included in the acquisition structure for the purposes of tax planning undertaken at group level. Whilst the investment was taking place in the US, the inclusion of LLC 5 (as a UK resident LLC) in the structure was the means by which debt was pushed down to the UK, because of the UK's "generous tax regime for interest deductions".

HMRC challenged LLC 5's claim for tax relief, as non-trading loan relationship debits, for the interest payable on the loan notes on two alternative bases: firstly based on a transfer pricing challenge pursuant to section 147(3) Taxation (International and Other Provisions) Act 2010; and secondly on the basis of the "unallowable purpose" rule in section 441 Corporation Tax Act 2009.

FTT's original decision

The taxpayer was successful before the FTT, though the basis on which it succeeded in relation to "unallowable purpose" was, more widely, problematic.

The FTT found that LLC 5 had a "main purpose" of securing a tax advantage on the basis that the securing of a tax advantage was an "inevitable and inextricable" consequence of entering into the debt which, being more than incidental, should be regarded as a main purpose. However, the FTT went on to find that all of the debits arising in respect of the loan should be attributed to the commercial main purpose for which the loan was entered into, being the furtherance of its business of making and managing investments. None of the debits were attributed by the FTT to the tax avoidance main purpose.

UT's reversal

Although the result of the FTT's decision was therefore to allow the deductions, the basis for the FTT's reasoning gave rise to a wider concern that any taxpayer entering into debt, however strong its commercial motivations in doing so, might arguably have a tax avoidance main purpose, simply on the basis that the loan would generate an interest deduction. It had been hoped that the Upper Tribunal (Tax and Chancery Chamber) ("**UT**") would clarify this point, accepting that it cannot be right to say that all loans entered into inevitably have an unallowable purpose.

Instead, however, HMRC's appeal to the UT has had a very different outcome, giving rise to further uncertainty as to the overall scope of the unallowable purpose legislation.

As regards transfer pricing, the key issue was that the loan notes did not contain certain covenants which a third party lender would have required, in order to secure the expected dividend flows up through the structure.

Importantly, the tax planning in relation to the acquisition structure included a relatively unusual feature, which was that LLC 4 had voting control of LLC 6, but LLC 5 did not. Therefore LLC 5 had no control over the flow of dividends relating to the preference shares in LLC 6. This was not a concern to LLC 4, as lender, because it controlled LLC 6. However, this would not have been the case for an arm's length lender to LLC 5, which would have naturally sought covenants (including from LLC 6 and from the target group) to protect its position. The FTT determined that such covenants would have been provided and therefore found in favour of the taxpayer in respect of transfer pricing.

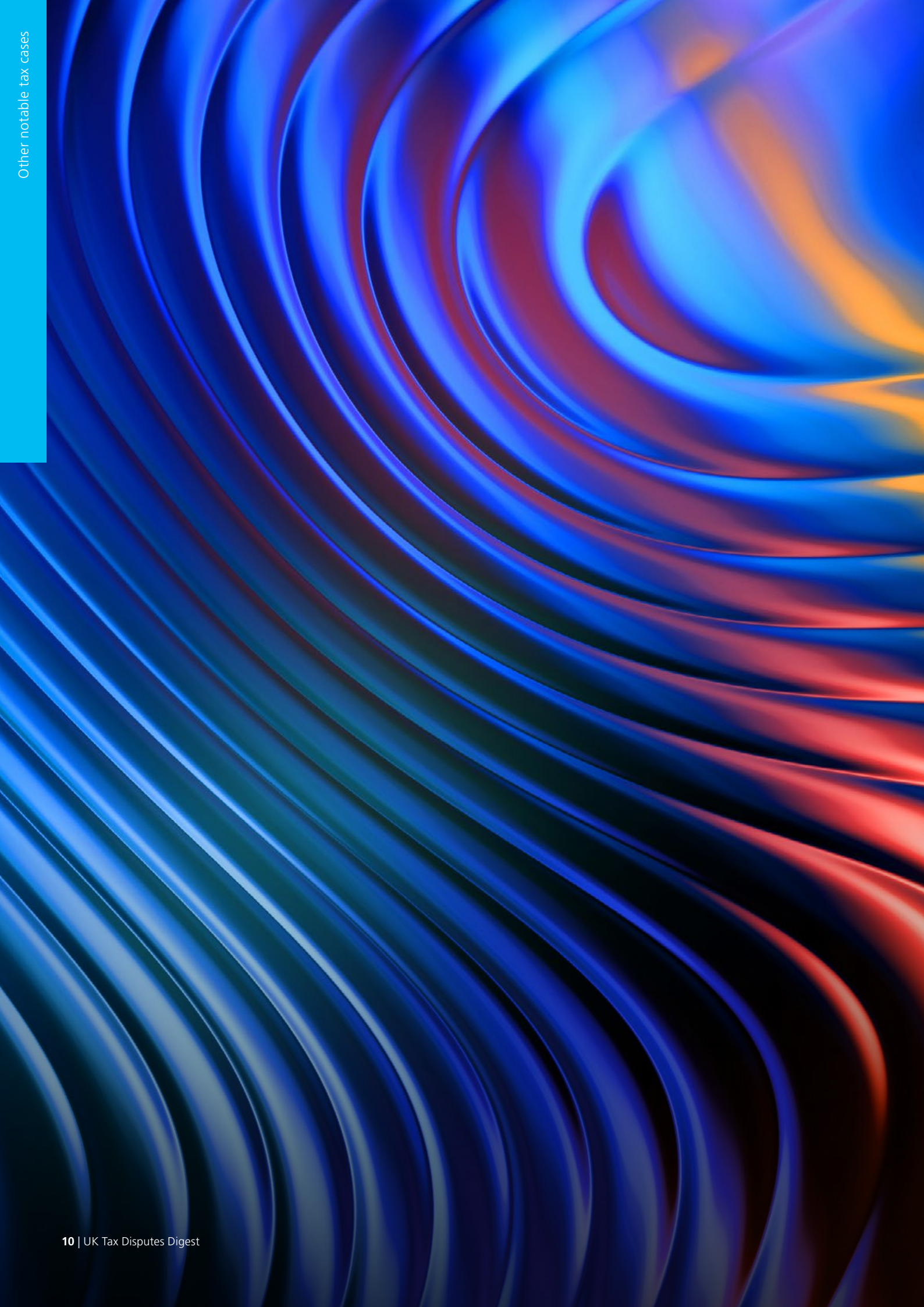
The UT concluded that the FTT had erred in law in permitting third party covenants absent from the actual transaction to be taken into account when considering whether an independent lender would make a $4 billion loan to LLC 5. On that basis, HMRC's appeal was allowed.

That decision gives rise to a somewhat odd result where, as here, the actual lender (LLC 4) had no reason to seek such covenants which would, in broad terms, simply have replicated the structural control which it already had. However it may be that this decision is somewhat limited to its particular facts. In a more normal acquisition structure, LLC 5 (as borrower) would have had control of LLC 6 and that factor would have been relevant to the basis upon which an arm's length lender would have been prepared to lend to LLC 5.
Having decided to allow HMRC's appeal, the UT had no need to consider unallowable purpose, but it chose to do so in any case. It considered that the relevant question is whether the loans would have existed at all if the benefit of the tax relief had never existed. The answer to that question in this case was that, in the UT's view, there would have been no LLC 5 and no loans if the UK had not provided tax relief for interest in these circumstances. Accordingly, the UT held that all of the debits should be attributed to the unallowable purpose.

The UT's comments on unallowable purpose are strictly *obiter dicta*, but what the UT said is likely to significantly increase the uncertainty as to the extent to which deductions may be susceptible to challenge on this basis.

Comment

Given the amounts of tax involved, this case may be subject to further appeal. Subject to the outcome of any appeal, this case would appear to give much ammunition to HMRC in seeking to challenge deductibility of loan relationship debits on grounds of unallowable purpose, in particular in the context of acquisition finance where the acquisition structure has been designed with tax planning objectives in mind. Further, it should serve as a reminder of the need to evidence the (non-tax) commercial intent which underlies acquisition structuring decisions, particularly where there are key commercial drivers which it may be necessary to demonstrate subsequently, should an HMRC challenge be forthcoming.



Other notable tax cases

Oppenheimer v HMRC [2022] UKFTT 00112 (TC)

The FTT considered whether an individual, tax resident in both the UK and South Africa under their respective domestic rules, was treaty resident in the UK in respect of certain tax years. The FTT determined that the taxpayer's personal and economic relations ("centre of vital interests") were closer to South Africa, and also that the taxpayer had a habitual abode there for the purposes of the double tax treaty. The decision is of potential relevance to many high net worth clients who may be considered dual tax resident.

A Taxpayer v HMRC [2022] UKFTT 133 (TC)

A taxpayer won her appeal against HMRC in the first ever case on the UK's statutory residence test. The key issue before the FTT was whether the taxpayer was UK resident under the "sufficient ties" test, which would, in the specific circumstances, have only been the case had the taxpayer spent 45 days in the UK in the relevant tax year. The taxpayer successfully argued that a portion of her day count should be disregarded under the exclusion for "exceptional circumstances beyond the taxpayer's control". The decision provides the first judicial guidance on what will constitute such "exceptional circumstances".

Hoey and others v HMRC [2022] EWCA Civ 656

The Court of Appeal determined that it had no jurisdiction to decide whether HMRC's wide statutory discretion to collect income tax other than by means of PAYE had been exercised properly. Should the taxpayer consider the discretionary power improperly exercised, it should pursue the claim via judicial review (for which the appropriate venue is normally the High Court). The decision provides clarity on the appropriate court for challenging HMRC's exercise of its discretionary powers. The court also definitively set out its view that HMRC should only have recourse to the transfer of assets abroad legislation in cases of tax avoidance which cannot effectively be countered in any other way.

HMRC v Perfect [2022] EWCA Civ 330

The Court of Appeal found that, in accordance with the provisions in the European (Withdrawal) Act 2018, a referral from a UK court or tribunal to the CJEU prior to 31 December 2020 will be binding on and in the UK, even where the judgment is handed down later than that date. This is of importance to those (whether parties to the particular litigation or not) who are waiting to hear the outcome of referrals made to the CJEU prior to the end of the implementation period.

Embiricos v HMRC [2022] EWCA Civ 3

The taxpayer lost his appeal against the UT's decision that HMRC had no power to issue a partial closure notice ending the enquiry into the taxpayer's ability to claim the remittance basis of taxation where it was not able to compute the tax due as a result of the failure of the claim. The practical result of the Court of Appeal's decision was that the taxpayer had to provide details of their foreign income and gains to HMRC before a partial closure notice could be issued (after which it would be possible for the taxpayer to appeal to the FTT, which they had been hoping to do without needing to provide details of their unremitted income to HMRC).

HMRC v NCL Investments Ltd and another [2022] UKSC 9

The Supreme Court held that accounting debits relating to the grant of share options to employees were a deductible expense in computing the profits of the taxpayer's trade for corporation tax purposes. HMRC failed in its argument that the accounting debits should be disallowed because the taxpayer had not – in reality – "incurred" any cost in issuing the options.

McClean v Thornhill [2022] EWHC 457 (Ch)

The judgment of this professional negligence case concerning advice provided by a leading tax silk on now infamous tax-advantaged "film schemes" is interesting for tax practitioners and their clients alike. Here, the High Court found that the defendant owed no duty of care to the film scheme investors, given that the investors were not his clients (he was instructed by the film scheme provider), and that the information memorandum advised the investors to take their own independent advice on their participation in the schemes (and, in order to subscribe to the schemes, the investors were required to warrant that they had done so).

Whispering Smith Ltd v Revenue & Customs [2022] UKFTT 165 (TC)

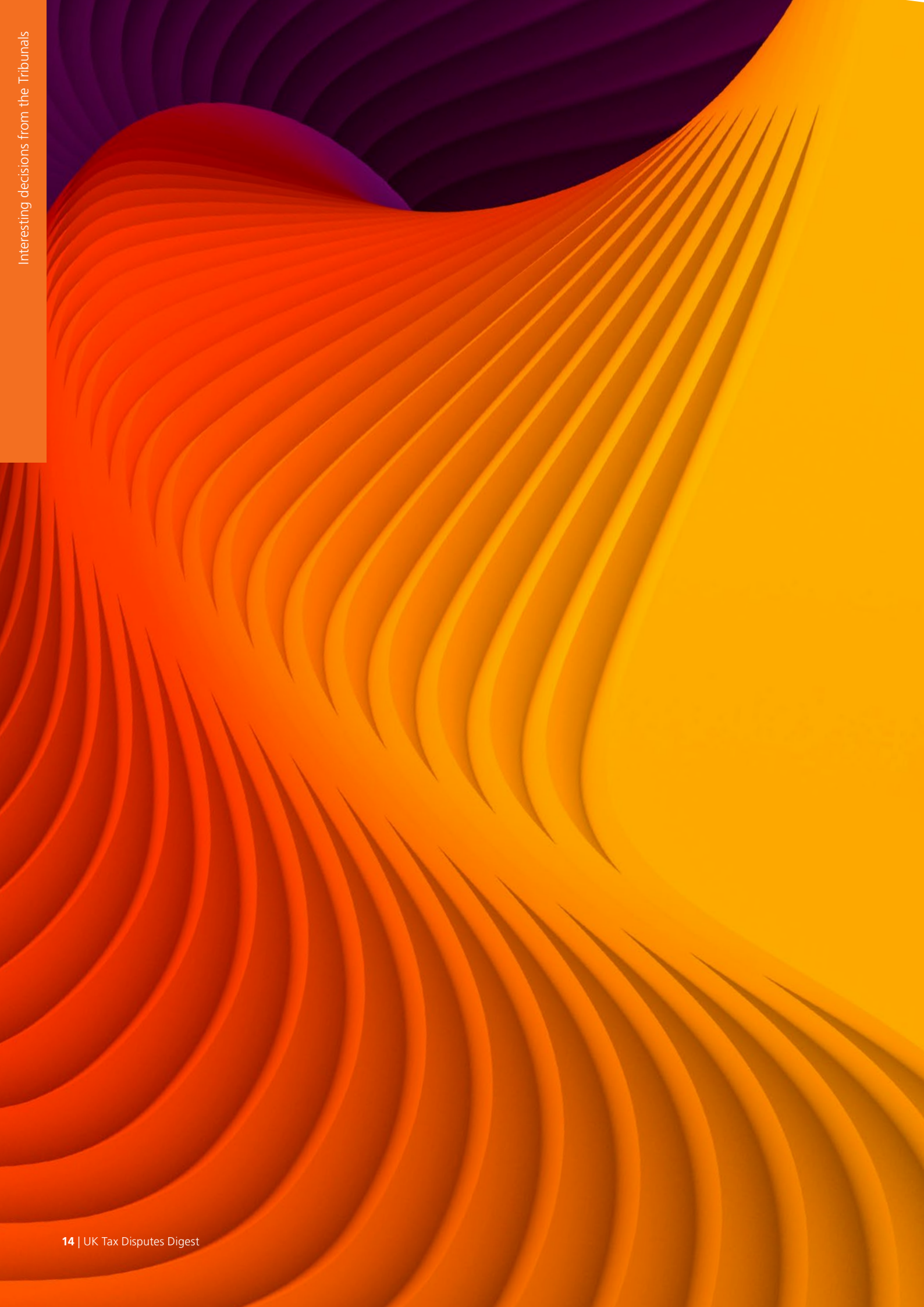
The FTT dismissed a taxpayer's appeal against penalties for failing to comply with a follower notice, in the first case on follower notices since the Supreme Court's decision in *Haworth*. The FTT applied *Haworth* to determine that the decision of the Supreme Court in *UBS* was a judicial ruling "relevant to" (i.e., defeating the purported tax advantage claimed by) the taxpayer. It decided that it was not reasonable in all of the circumstances for the taxpayer not to comply with the follower notice. However, penalties were reduced to reflect taxpayer co-operation.

Zipvit Ltd v HMRC (No 2) [2022] UKSC 12

Further to the ECJ's judgment on the Supreme Court's reference on this issue, the Supreme Court held that the claimants could not claim to deduct amounts of VAT for which they had not been charged. The key reason for this finding was that VAT had not been "due or paid" within the means of Art 168(a) of the VAT directive, as neither the supplier nor customer had treated the supplies as subject to VAT at the time, nor had the supplier requested payment of VAT in the meantime (nor paid it to HMRC). This important case on VAT recovery will discourage taxpayers from seeking recovery of input tax in analogous circumstances.

HMRC v Atholl House Ltd [2022] EWCA Civ 501; *Kickabout Productions Ltd v HMRC* [2022] EWCA Civ 502

While two separate cases, these were both heard by the Court of Appeal on the same day by an identical bench, and concerned the same issue: whether a hypothetical contract between the radio presenters and the broadcasters in question would be a contract of employment. Should the court answer "yes" to this question, the presenters would be within the IR35 legislation and be taxed accordingly. The two Court of Appeal judgments contain important discussion covering how to apply the relevant tests contained in case law for ascertaining the IR35 status of a contractor's arrangement. Since April 2021, this has been of particular importance to medium & large businesses, which are now liable to account for PAYE and NICs under the relevant legislation. Previously, the personal services company was liable.



Interesting decisions from the Tribunals

Staleness is not a valid challenge to discovery

In *HMRC v Martino* [2022] UKUT 00128, HMRC's time limits for making discovery assessments came under the lens of the UT.

Background

In order to open a valid enquiry into a taxpayer's self-assessment return, HMRC must give written notice of its intention to do so within a specific time limit (with extended time limits where returns are either filed late or subsequently amended), commonly referred to as the "enquiry window". However, if the enquiry window has expired, HMRC can still make an assessment for tax where it "discovers" a loss of tax, referred to as "discovery assessments".

The purpose of having time-limited enquiry windows is to provide some sense of finality to taxpayers. The concept of "discovery" effectively overrides those normal time limits and is therefore a material power for HMRC. For that reason, HMRC's ability to make discovery assessments is subject to various safeguards and controls set out in legislation (including, like the position for notices of enquiry, time limits for HMRC to make such assessments).

The time limit for HMRC to make a discovery assessment will depend on the taxes involved. For income tax and capital gains tax, for example, the statutory time limit is generally four years after the end of the tax year in question. That time limit is extended in certain circumstances, for example where the loss of tax was brought about "carelessly" (six years) or "deliberately" (twenty years).

The case

In *Martino*, HMRC formed the view that the taxpayer was involved in unauthorised payments of approximately £34,500 as a beneficiary of a registered pension scheme in January 2010. In May 2014, HMRC made a discovery assessment for an "unauthorised payments charge" under ss. 208-209 Finance Act 2004.

The FTT held that, because HMRC had discovered by mid-2011 that the taxpayer was concerned in the making of an unauthorised payment but did not make the assessment until May 2014, any discovery had become "stale" – thereby rendering the assessment invalid, in line with case law well-established at that time.

HMRC's subsequent appeal on this issue to the UT was stayed whilst the Supreme Court also considered discovery assessments in *HMRC v Tooth* [2021] UKSC 17. In that landmark decision, the Supreme Court, *obiter dicta*, rejected the concept of staleness as a valid reason to challenge a discovery assessment, and confirmed that the only relevant time limits are those specifically imposed by statute (described above).

The UT in *Martino* followed the *obiter dicta* from *Tooth* and remade the FTT's decision to dismiss the taxpayer's appeal.

Comment

Given the position of the Supreme Court in *Tooth*, the UT's decision comes as no surprise. It is now clear that a discovery cannot become "stale" and cease to be a discovery if there is a delay between the making of the discovery and the making of the subsequent assessment. In practice, this means that HMRC will have more time to make discovery assessments than may have previously been permitted, subject to the statutory time limits and other conditions for making discovery assessments (as well as any potential judicial review challenge if HMRC exercises its powers improperly).

White space disclosure is not a defence against carelessness

In *Johnson and another v HMRC* [2022] UKFTT 00156 (TC), another case concerning discovery assessments, the FTT dismissed a tax adviser's arguments suggesting that white space disclosure could serve as a defence against carelessness (which, as noted above, carried an extended time limit for HMRC to make an assessment).

Background

Aside from time limits and the need for a "discovery", where a taxpayer has delivered a self-assessment return, HMRC must be able to demonstrate that one of two gateway conditions is satisfied in order to make a discovery assessment:

— the loss of tax was brought about carelessly or deliberately by the taxpayer (or a person acting on their behalf); or
— a hypothetical HMRC officer could not have been reasonably expected to be aware of the loss of tax on the basis of information made available at the time when HMRC ceased to be able to open an enquiry into the relevant period (or, where an enquiry has been opened, when a relevant final or partial closure notice was issued).

The case

In *Johnson*, the taxpayers had entered into a mis-sold interest rate hedging product, relating to a loan taken out to purchase a rental property. Following a Financial Conduct Authority review, the taxpayers were awarded a redress payment of approximately £101,000, approximately £18,500 of which had been identified as interest against which tax had been deducted at 20%. For the non-interest portion of the payment, the taxpayers' agents provided a white space disclosure on the relevant returns noting that a compensation payment had been received during the tax year in respect of interest rate hedging products which was not considered taxable. However, that position was in contrast to HMRC guidance that such redress payments were in fact taxable because tax relief would previously have been claimed as an allowable business expense for the payments under the hedging product.

The FTT, whilst not doubting that the agent acted in good faith, did not agree that the agent took reasonable care when tested against the standard of a reasonably competent tax adviser. The agent failed to look beyond HMRC's guidance and did not take steps to establish the full facts relating to the payment, and given the information he was privy to, should have known the redress payment related to the allowable business expenses the taxpayers had previously claimed, and therefore that it should have been taxable.

The agent, representing the taxpayer before the FTT, tried to argue that, given that the white space disclosure contained precise details of the amount and its source, it complied with HMRC Statement of Practice SP 1/06 (SP 1/06) (which provides that taxpayers can protect against discovery assessments in certain circumstances) and provided enough information for an HMRC officer to appreciate that the self-assessment in the relevant tax returns was insufficient. As a result, the position taken was a reasonable one and neither he (nor the taxpayers) should be treated as having acted carelessly.

However, the FTT dismissed the tax adviser's arguments on this point as misconceived. SP 1/06 is concerned with the gateway condition about information given to a hypothetical officer, and does not provide a defence against the separate gateway condition about the behaviour of a taxpayer or their agent. The discovery assessments made by HMRC were therefore valid.

Comment

The case highlights that a white space disclosure is not a "get-out-of-jail-free" card for arguing against the validity of discovery assessments and does not mitigate the duty of the taxpayer, or their agents, to have acted with reasonable care in compiling their tax returns.

Discovery cannot be made prior to the enquiry window closing

In *Curtis v HMRC* [2022] UKFTT 172 (TC), the FTT allowed the taxpayer's appeal against a pensions unauthorised payments charge and surcharge, deciding that HMRC's discovery assessment was invalid on the basis that it had been issued before the enquiry window had closed.

For a summary of the relevant rules on enquiry windows and discovery assessments, please see our summaries of the decisions in *Martino* and *Johnson* above.

The case

In this unfortunate case, the taxpayer had sought and relied upon independent advice from a financial adviser when she came under financial difficulties in 2012. Her workplace pension, valued at approximately £49,000, was transferred to a private pension and in a separate (and, in her mind, unlinked) transaction, she received a loan of £20,000. The taxpayer subsequently repaid around £13,500 of the loan but ultimately lost her entire pension. Unbeknownst to her, the private pension fund made a transfer of £20,000 to the finance company that provided the taxpayer with the loan, inextricably linking the transactions and resulting in an unauthorised member payment.

The taxpayer came onto the radar of HMRC and, following a prompt by HMRC (having not previously been registered for self-assessment), delivered a completed tax return for the tax year 2012/13 on 19 May 2016 (i.e., late), which meant that the enquiry window closed on 31 July 2017. However, apparently for reasons of efficiency, HMRC chose to issue a discovery assessment to the taxpayer on 17 February 2017 for an unauthorised payments charge and surcharge, rather than opening an enquiry.

The FTT agreed that the taxpayer was *prima facie* liable for the tax, but upheld the appeal on the basis that neither of the two conditions for a valid discovery assessment had been made:

- Firstly, the taxpayer had not acted carelessly by failing to mention the transfer of her pension when completing her self-assessment return at HMRC's request, as she had no information which identified the link between her pension and the loan and there was no way she could have reasonably obtained such information. There was no suggestion that the taxpayer had acted deliberately either.
- Secondly, the FTT held that it was implicit in the relevant legislation that the "discovery" required by the relevant legislation should be made after the expiry of the enquiry window where HMRC was not aware of the loss of tax in question. HMRC could have opened an enquiry into the return and, having failed to take advantage of the enquiry window, should not be able to rely on what the FTT described as a "strained construction" of the discovery legislation.

Comment

In reaching its decision, the FTT agreed with the older decision of the Special Commissioners in *Lee v HMRC* [2008] SPC 715 but went against another FTT decision in *Tim Norton Motor Services Ltd and another v HMRC* [2020] UKFTT 503 (TC), thereby swinging the balance of authority back in favour of the taxpayer. Given the differing decisions and the latest case being contrary to established HMRC guidance, HMRC may well seek to appeal the decision to the UT.

Taxpayer given permission to appeal over four years late

In *Badejo v HMRC* [2022] UKFTT 202 (TC), the FTT granted the taxpayer's application for permission to appeal against an assessment to capital gains tax, even though the notice of appeal had been delivered over four years outside the statutory time limit.

Background

Where a taxpayer disagrees with a decision made by HMRC, such as a notice of assessment, the appeal procedure will vary depending on the taxes involved. For most direct taxes (i.e., income tax, capital gains tax and corporation tax), the taxpayer must first appeal to HMRC, usually within 30 days from the date of the decision. HMRC will consider the merits of the appeal before issuing a final decision letter, although the taxpayer can choose to notify its appeal to the FTT before receiving a response.

It is important, therefore, to ensure that appeals are made within statutory time limits. Whilst late appeals can be made in certain circumstances, for direct tax cases, this requires HMRC's consent or, where such consent is not given, permission from the FTT. The relevant legislation provides that HMRC is only obliged to accept a late appeal if satisfied that there was a reasonable excuse for missing the deadline and that the request for making the late appeal was made without unreasonable delay after that excuse ended. The FTT, on the other hand, is not limited by these statutory conditions.

The case

The taxpayer owned a property in London, which she had rented out and later disposed of in the tax year 2005/06. No capital gains tax figure had been provided in the tax return submitted for that period. In response, HMRC opened an enquiry and ultimately issued a notice of assessment for capital gains tax and penalties on 21 August 2013. The taxpayer appealed but this was only received by HMRC on 26 October 2017. HMRC subsequently refused to admit the late appeal.

The FTT applied the well-known test set out in *William Martland v HMRC* [2018] UKUT 0178 (TCC). The starting position is that permission should not be granted unless the taxpayer demonstrates that it should be. The three-stage test in *Martland* then requires a balancing exercising, taking into account: (i) the length of the delay; (ii) the merits of any reasons for the delay; and (iii) the prejudice that would be caused to the respective parties by the grant or refusal of permission.

Despite the "serious and significant delay", the FTT granted permission to appeal late for the following key reasons:

— The taxpayer's agent had assured her on more than one occasion that a notice of appeal had been submitted and the taxpayer was under the genuine impression that the notice of appeal had indeed been submitted. Upon being made aware by HMRC that this was not the case, she took steps to have it submitted. Although in some circumstances it might have been the case that using another agent (when the shortcomings of the existing one had become apparent) would have been a reasonable course of action, the taxpayer had experienced medical issues that meant that that was not an avenue realistically open to her. In fact, these difficulties were the reason why the appellant engaged a professional agent, having reportedly been encouraged to do so by an HMRC officer dealing with her case.
— The FTT considered that there would not be a substantial detriment to HMRC, noting that (i) HMRC had contributed to the overall delays, (ii) although the original investigating officer had moved on, this is not uncommon, and (iii) it is highly unlikely that anyone within HMRC had actually considered the case closed, only for the taxpayer to seek to reopen it years later.

Comment

The circumstances of this case are unusual in that the taxpayer's agent had apparently failed to file a notice of appeal despite giving repeat assurances. This case nevertheless serves as a useful reminder of the importance of making tax appeals within the time allowed. Taxpayers should ensure that they are aware of the relevant appeal procedures, which will vary depending on the circumstances.

FTT amends information notice in light of HMRC "fishing trip"

In *Jenner v HMRC* [2022] UKFTT 203 (TC), the FTT confirmed that HMRC is not permitted to make broad requests under taxpayer information notices for the purposes of "fishing" for information. In that case, this meant that certain details of personal expenditure were not deemed reasonably required, while basic financial information was considered reasonable.

Background

HMRC has the ability to issue information notices under schedule 36 to the Finance Act 2008 ("**Schedule 36**") to compel the sharing of information or documents in order for HMRC to check the tax position of, or collect tax debts from, UK taxpayers. Under Schedule 36, there are different types of information notices depending on who the receipt may be (e.g., taxpayer notices or third party notices) but, in each case, there are strict controls and safeguards that must be followed before such notices can be issued. In particular, the requested information or documents must be "reasonably required" by HMRC for the purpose of checking the tax position of, or collecting a tax debt from, the relevant taxpayer(s).

The case

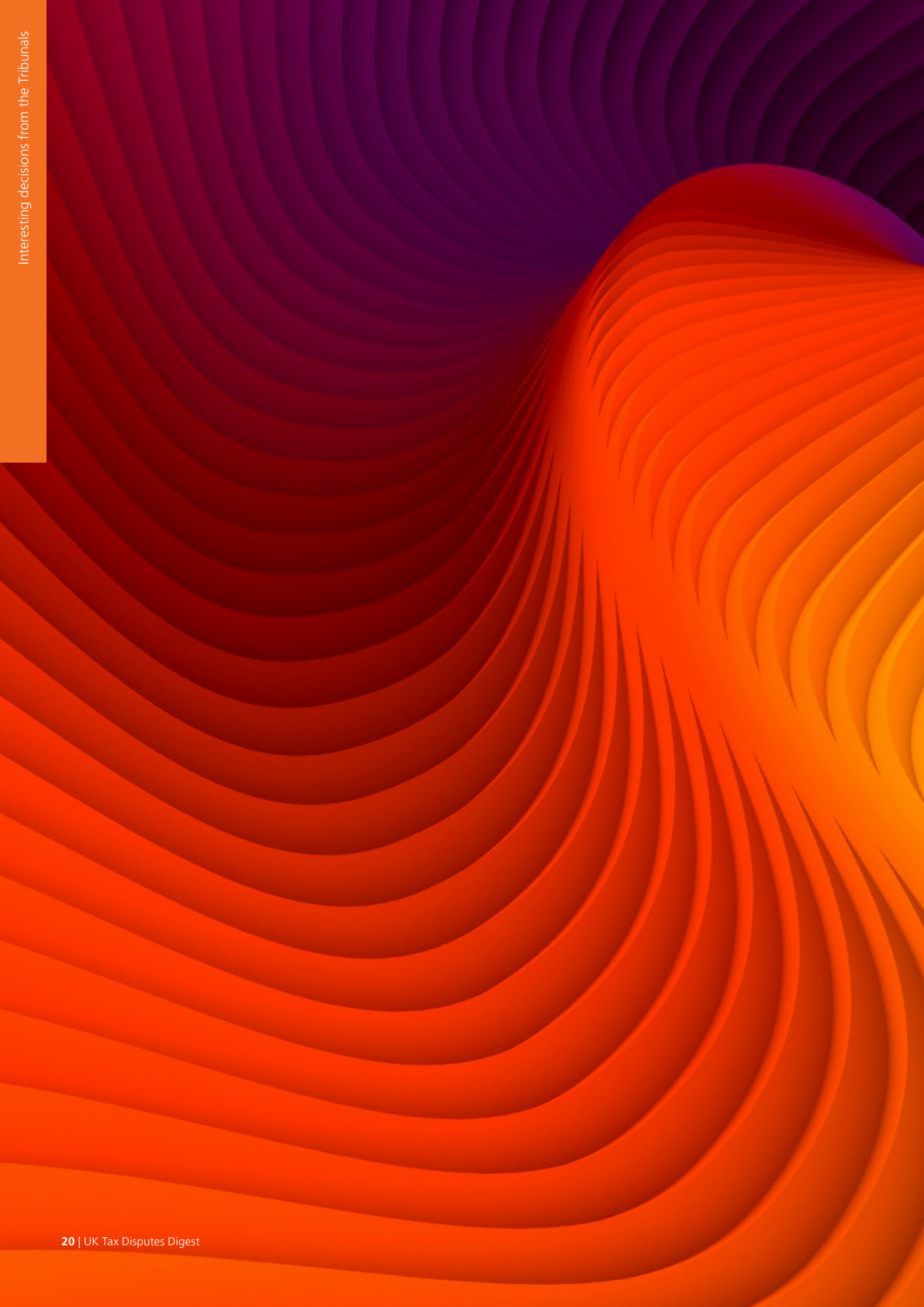
In *Jenner*, HMRC issued information notices to the taxpayer for the tax years ending in 2018 and 2019, requiring full details of his household and personal expenditure; financial information detailing any remuneration he had received from companies of which he was a director; any sums drawn from trusts, partnerships or other entities; and details of his personal accounts. Jenner appealed against the information notices on the grounds that the information was not reasonably required to check his tax position, and that the broad scope of the notices suggested that HMRC were in fact embarking on a "fishing expedition".

The FTT confirmed that HMRC is not permitted to make broad requests for the purposes of fishing for information but that this does not mean it needs suspicion in order to check a tax return. HMRC is entitled to information or documents reasonably required for the purpose of carrying out an investigation or enquiry. Broad requests made for the purposes of fishing for information would not meet the "reasonably required" test.

On that basis, the FTT set aside the requirement for the information on the taxpayer's household expenditure, deciding that HMRC had failed to demonstrate that such information was reasonably required and that taxpayers "should not be required to divulge details of [their] personal expenditure if that could be avoided." The requirement to provide the other information was upheld, although varied in part. The FTT drew on the case of *Bemal Patel v HMRC* [2017] UKFTT 323 (TC), which stated that basic financial information (such as bank accounts, financial assets, and liabilities) is reasonably required to check that tax returns are correct and complete.

Comment

The decision provides further guidance on what type of information may be seen as part of a "fishing expedition" by HMRC. Further, in reaching its decision, the FTT held that the burden of proof rested with HMRC to show that the information requested under a taxpayer notice is reasonably required. This may be contrasted to the decision in *Joshy Mathew v HMRC* [2015] UKFTT 139 (TC), where the FTT considered that the presumption that a statutory authority has acted lawfully meant that the "reasonably required" burden rested with the taxpayer. That other case, however, concerned a third party notice – the basis for the difference being the procedure for issuing a third party notice (which, unlike a taxpayer notice, requires HMRC to obtain the FTT's approval before being issued). Strikingly, the FTT also set out a concern that some aspects of the evidence given by the HMRC officer involved "appeared to be incorrect and potentially misleading".



UT denies HMRC permission to raise new point in tax appeal

In *Wyatt Paul v HMRC* [2022] UKUT 116 (TCC), the UT denied permission for HMRC, as respondent, to raise a new argument that had not previously been argued before the FTT.

Background

In *Wyatt Paul*, the taxpayer appealed an unfavourable FTT decision to the UT. The taxpayer had initially sought and obtained permission to argue a number of grounds, but subsequently dropped all but one, namely whether a notice of enquiry had been properly served. In its response, HMRC raised a new argument: that the taxpayer was estopped by convention from denying a valid enquiry had been opened in accordance with the Supreme Court's decision in *Tinkler v HMRC* [2021] UKSC 39. The proceedings before the UT concerned whether HMRC was entitled to do so.

The taxpayer relied on well-established case law on the relevant principles regarding admission of a new point in an appeal, with particular focus on *Singh v Dass* [2019] EWCA Civ 360 where Haddon-Cave LJ set out the following principles:

— an appellate court will be cautious about allowing a new point to be raised on appeal that was not raised before the first instance court; and
— an appellate court will not, generally, permit a new point to be raised on appeal if that point:

  - necessitates new evidence; or
  - if it had been run in the original hearing it would have resulted in the trial being conducted differently with regards to the evidence at the trial.

HMRC did not dispute these principles but argued that they were not relevant on the basis that such case law concerned a situation where a party loses at first instance and seeks to rely on a new point on appeal. As such, HMRC submitted that it did not need to even ask for permission.

Decision

The UT confirmed that the principles described above are party-neutral, and therefore apply equally to appellants and respondents. On that basis, HMRC did need the UT's permission to raise a point that had not been argued before the FTT.

In respect of HMRC's estoppel argument, the UT found that HMRC could have raised the issue before the FTT, but failed to do so. The UT agreed with the taxpayer that, had the estoppel argument been raised before the FTT, the taxpayer would have sought to cross-examine the evidence in an oral hearing, thereby the FTT's determination would have been conducted differently with regards to the evidence. Even if the appellant had not made the case, the FTT themselves may have used their own powers to ensure an oral hearing took place.

Comment

The case is somewhat unusual in that it involves a party attempting to raise a new argument despite being successful at the previous appeal stage. However, the decision highlights the importance for taxpayers to ensure that all relevant arguments are raised at the first instance given the high threshold that has to be overcome to persuade the UT (or higher appellate courts) to exercise their discretion to allow a new argument to be raised, whether by appellant or respondent.

Other developments

HMRC announcements

HMRC's Annual Report published

In July 2022, HMRC published its annual report and accounts for 2021/22, including the Tax Assurance Commissioner's report in relation to tax disputes. Some key headline figures from that report:

— In 2021/22, there were approximately 15,600 new appeals notified to the FTT and approximately 36,500 appeals in progress on 31 March 2022.
— It typically takes 12 to 18 months for an appeal to be resolved in the FTT.
— In 2021/22, HMRC had an 88% success rate in appeals before the FTT.
— Approximately 77% of HMRC statutory reviews in 2020/21 upheld the decision of the original HMRC officer (excluding reviews relating to automated penalties and surcharges).
— Reduced economic activity during the pandemic affected HMRC's additional revenues secured through compliance activities, which (at approximately £30.8 billion) remained at a similar level to the preceding year.

HMRC's annual report acknowledged service deficiencies in 2021/22 and it is clear from HMRC's performance update for April to June 2022 that service issues continue to be problematic. Our own experience of dealing with HMRC is consistent with this.

HMRC names avoidance schemes and their promoters for first time

HMRC has publicly named specific tax avoidance schemes and their promoters for the first time, warning users in the identified schemes that they should withdraw as soon as possible to prevent building up a large tax bill. Both of the two named schemes involved individuals agreeing an employment contract and working as a contractor. The schemes pay contractors the National Minimum Wage, with the remainder of their wage paid through a loan to try to avoid National Insurance and income tax.

This is the first time that HMRC has used new powers to name tax avoidance schemes and their promoters, and forms part of a broader campaign to warn the public about tax avoidance schemes (such as the "Tax Avoidance – Don't Get Caught Out" campaign). HMRC has stated that it intends to regularly update the list of published schemes and promoters.

HMRC publishes data on Diverted Profits Tax and Profit Diversion Compliance Facility ("**PDCF**")

The UK's diverted profits tax ("**DPT**") is targeted at contrived arrangements whereby multinational groups ("**MNEs**") seek to divert profits earned in the UK to other jurisdictions where they pay little or no tax. Broadly, the purpose of DPT is to counteract the diversion of profits from the UK by MNEs that either:

— use entities or arrangements lacking in economic substance to exploit tax mismatches; or
— seek to avoid the creation of a UK permanent establishment that would bring a non-UK company within the charge to UK corporation tax.

DPT is a separate tax from UK corporation tax and is therefore subject to different rules (including being set at a higher main rate of 25%). However, DPT is intended to work alongside the UK transfer pricing regime and, in many cases, MNEs can avoid a liability to DPT by making an appropriate transfer pricing adjustment.

It is not uncommon for an MNE to find itself with outdated transfer pricing policies that do not reflect the reality of how its business operates in practice. MNEs making this mistake could find themselves subjected to a new type of forensic investigation by HMRC to test whether profits have been artificially diverted from the UK, as well as an upfront charge to DPT with no immediate right of appeal (usually involving very large amounts of tax).

According to new published data, in 2020 to 2021 HMRC issued 78 DPT preliminary notices to 27 groups and 59 DPT charging notices to 23 groups. HMRC is currently carrying out around 100 investigations into multinationals with arrangements to divert profits (excluding those who have registered under the PDCF) and the total amount of tax under consideration in these cases was £3.8 billion at the end of March 2021.

HMRC has also published data on the use of the PDCF, a voluntary disclosure facility that allows MNEs to disclose any tax errors relating to profits diverted out of the UK. According to that data, there were 22 resolved cases in 2020-21, with an average of 12 months from first registration meeting to receiving a decision from HMRC and 96% of registrants having had their final proposals accepted.

Updates to FTT Practice Directions

Allocation of tax cases

Upon receipt of a notice of appeal, the FTT will allocate a case into one of four categories:

— "Default Paper" cases (usually disposed of without a hearing);
— "Basic" cases (usually disposed of after a hearing, following minimal exchange of documents);
— "Standard" cases (usually subject to more detailed case management than basic and disposed of after a hearing); and
— "Complex" cases (subject to special rules in relation to cost awards and eligibility of transfer to the UT).

With effect from 1 June 2022, a new Practice Direction takes effect to give further guidance in relation to the categorisation of cases in the FTT. Of most relevance to CMS' clients will be the updated guidance regarding "Complex" cases. The Practice Direction confirms that these are cases which require voluminous or complex evidence or a lengthy hearing (more than five days), involve a complex or important principle or issue, or otherwise involve large financial sums (defined as at least £750,000 for direct tax cases and at least £2m for indirect tax cases).

Whether a case is categorised as "Complex" will have important implications for a taxpayer's costs. In the FTT, the general rule is that each party bears its own costs. Therefore, if you eventually win your appeal, you will not be able to recover any of your costs from HMRC. Equally, if you lose the appeal, you usually do not have to worry about paying HMRC's costs. There are exceptions to that general rule, primarily where an appeal is treated as "Complex" and the taxpayer has not opted out of the associated costs regime within the time permitted.

Witness summonses and production of documents

On 15 June 2022, the FTT issued a Practice Statement dealing with witness summonses and orders to produce documents. The new Practice Statement details the ability of the FTT to issue summons to a witness, either by its own initiative or on application of a party, or order a person to answer any questions or produce any documents which relate to an issue in proceedings. Such power is limited in scope to individuals residing or with a place of business in the UK, with caution being exercised should the individual only be temporarily in the UK.

An application to summon a witness is confined to where a party knows or believes an applicant will not attend, or the attendance is conditional on a summons, and a request of the individual should have first been made by the applicant party. On rare occurrences, such voluntary request may not be needed but sufficient reasoning must be given to the FTT.

The Practice Statement sets out a large number of procedural steps that need to be met in making an application, but it is imperative to every application that the FTT is satisfied that the evidence sought is relevant to the issue in the proceedings, and an application should clearly set out the reasons why it would materially assist the FTT in its determination of the issue(s).

Evidence from abroad

Following the UT's decision in *Agabiaka (evidence from abroad; Nare guidance)* [2021] UKUT 286 (IAC), new guidance was provided by the FTT concerning the procedure to be followed when a party wishes to rely on oral evidence given by video or telephone from outside the UK. That decision treated as determinative the stance of the UK Foreign, Commonwealth and Development Office that the giving of oral evidence from another Nation State requires the permission of that State. Permission is not needed for written evidence, or for submissions (whether oral or written).

In *Medhurst v Revenue and Customs Commissioners [2022]* UKFTT 186 (TC), the FTT made it clear that the taxpayer in that case (who lived in Vietnam and was in poor health) could not give evidence via telephone from Vietnam unless the procedure set out above had been followed. In the end, the taxpayer gave permission for the hearing to proceed in his absence but with his submissions set out in writing beforehand.

Latest HMRC nudge letter campaigns

The behavioural science of "nudge theory" has become an increasingly used weapon in HMRC's arsenal over the last decade or so – i.e., the idea that people can be better directed towards a desired course of action through suggestion rather than obligation. UK taxpayers may have noticed the same concept at work when completing their online tax returns, where certain information is now pre-populated based on figures held by HMRC (the idea being that the taxpayer will likely accept those figures by default).
Over the last few months, HMRC has launched several nudge letter campaigns on various issues, as summarised below.

Overpayment of SEISS Grants (April 2022)

HMRC announced that letters would be sent to taxpayers whose entitlement to the fourth and/or fifth SEISS grant has decreased by more than £100, requesting that they repay the overpaid amount. Should a taxpayer have made an amendment after 3 March 2021 to their 2016/17 to 2019/20 tax returns which means they are no longer entitled to the amount claimed for their fourth and/or fifth SEISS grants, the taxpayer must repay the amount by which they were overpaid.

Should a taxpayer have been overpaid as set out above, HMRC will also consider turnover figures where such taxpayer has claimed the fifth SEISS grant. If they are eligible for the lower (30%) grant, but claimed the higher (80%) grant, they will have to repay the difference.

Taxpayers who disagree with the figures provided in the letter can appeal by writing to HMRC within 30 days of the date of the letter. Those who are unable to pay the sum in full may be able to set up a Time to Pay arrangement.

Share Sale Proceeds (May 2022)

HMRC is reviewing taxpayer positions relating to share disposals in the 2019/20 tax year, where declared self-assessment disposal figures differ from those declared by the purchasing company. The identified taxpayers will receive nudge letters prompting them to amend their returns.

CGT Lifetime Limit (May 2022)

Business Asset Disposal Relief ("**BADR**"), previously known as Entrepreneur's Relief, gives rise to a 10% rate of capital gains tax on the disposal of qualifying business assets or shares. In 2020, the BADR lifetime limit was reduced from £10 million to £1 million, taking account of earlier disposals.

HMRC is reviewing tax returns for the 2020/21 tax years to identify taxpayers who overclaimed relief on their gain, thus exceeding their lifetime allowance. Those contacted are asked to check their 2020/21 returns, make the necessary amends, and inform HMRC.

Provisional Roll-Over Relief (June 2022)

Under the Roll-Over Relief program, it is possible for a taxpayer to defer capital gains tax due on the disposal of certain business assets ("old assets") where the taxpayer acquires other assets ("new assets") costing the same as, or more than, the consideration received for the sale of the old assets. The relief allows payment of the capital gains tax to be postponed until the disposal of the new assets.

HMRC has announced that nudge letters will be sent to taxpayers who made provisional Roll-Over Relief claims in tax years up to and including 2017/18 but did not submit a final claim to supersede the provisional one within the time limit. The letter advises taxpayers to write to HMRC within 30 days if they have made a reinvestment of the proceeds within the relevant time limits, otherwise the assessments will be raised for the deferred capital gains from the original disposal.

Wealthy Individuals with Missing Tax Returns (June 2022)

HMRC's Wealthy External Forum has been sending nudge letters to taxpayers who have received notices to file returns for the tax years 2017/18 to 2019/2020, but have not yet done so. The letters are targeted at those who filed self-assessment returns for the tax years either side of the tax year which is the subject of the letter – but not that year.

The recipients are prompted to file missing returns by 22 August or to otherwise contact HMRC's helpline. In unresponsive cases, a calculation will be made based on data held by HMRC.

Benefits-in-Kind Discrepancies (July 2022)

HMRC's Wealthy External Forum has announced that taxpayers who have submitted tax returns for 2020/21 which do not encompass all benefits-in-kind shown on their employer's P11Ds will receive nudge letters.

The nudge letters encourage taxpayers to check their return and ensure there are no discrepancies between the information on their tax returns and their employer's P11D, and if there are, make any relevant corrections within 28 days.

Carry-back Gift Aid Elections (July 2022)

Before opening enquiries, HMRC's Wealthy External Forum is sending nudge letters to warn taxpayers who made amendments to their 2020/21 tax returns to include or amend a claim for Gift Aid carry-back. Given that elections to carry back a Gift Aid tax relief claim can only be made in an original tax return and not via an amendment, relevant taxpayers are requested to reinstate the original figure by a date stated in the nudge letter or risk an enquiry being opened.

Euro Pacific International Bank (July 2022)

Euro Pacific International Bank (EPB) in Puerto Rico, whose operations were suspended on 30 June 2022, is suspected of harbouring tax evasion and money laundering for its worldwide client base. In the UK, HMRC's investigations as to whether UK customers evaded UK tax or laundered the proceeds of crime are underway, with tax enquiries, criminal investigations and intelligence operations ongoing.

HMRC has since commenced a nudge letter campaign, targeting those who have been identified as holding accounts with the bank. This also follows HMRC's Twitter campaign which has been encouraging taxpayers to make any relevant voluntary disclosures through the Worldwide Disclosure Facility.

Action points

Any taxpayers who receive nudge letters, even those confident of their tax position, should seek professional advice as soon as possible. Whilst nudge letters do not make specific accusations and are rarely overtly threatening in tone, they are generally based on actual data held by HMRC. Taxpayers who ignore these letters do so at their peril – failure to take action or respond is likely to mean that there is an imminent risk of HMRC starting an investigation (either under civil procedures or, in cases of suspected fraud, using their criminal powers). Early disclosure may also mitigate penalties.

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