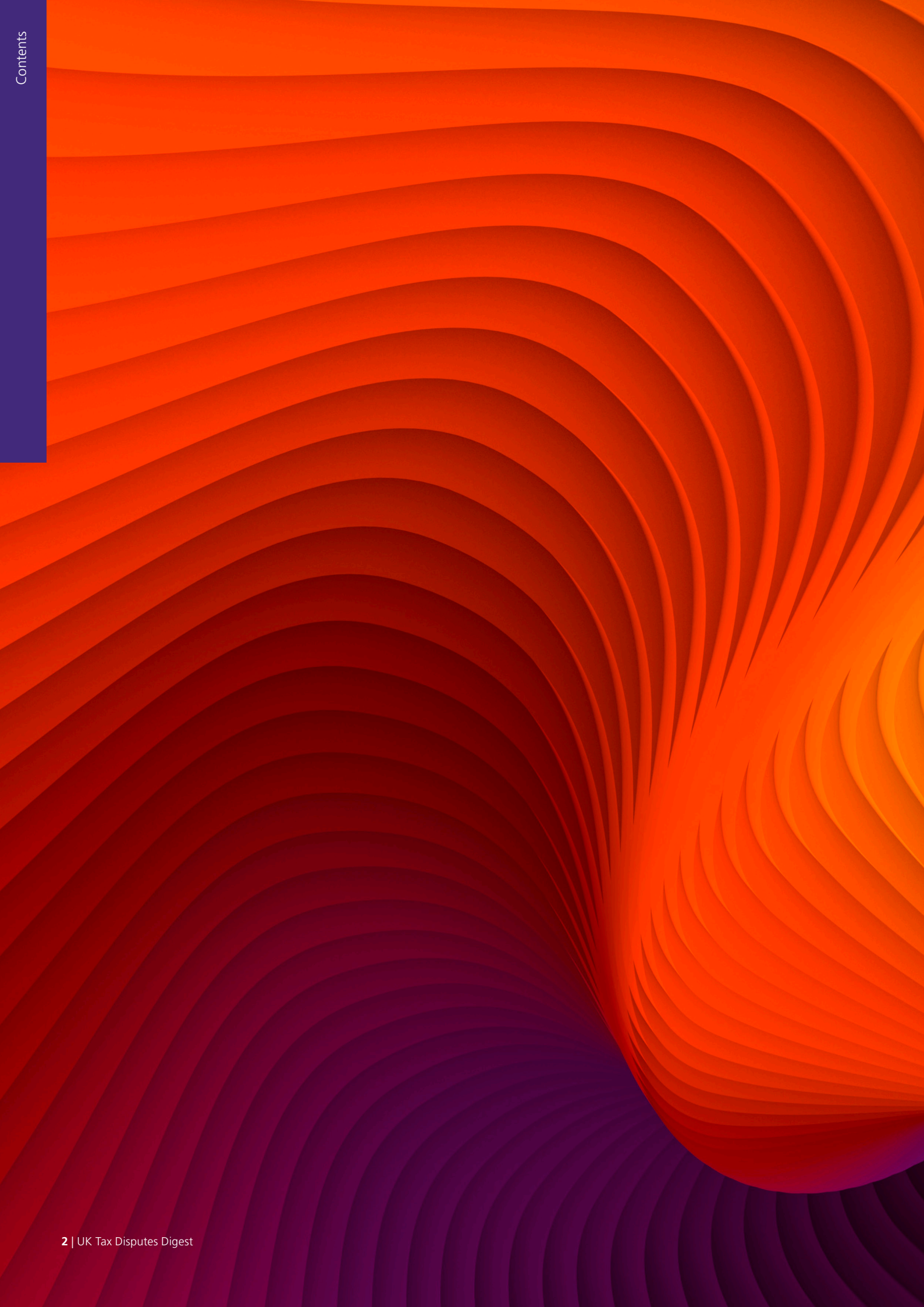
UK Tax Disputes Digest

November 2022



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Introduction

Welcome to the autumn 2022 edition of our UK Tax Disputes Digest: a high-level summary for heads of tax, finance directors, general counsel and other in-house professionals of key developments in contentious tax over the last few months.

The UK tax landscape has gone through a period of considerable turbulence since our last (summer 2022) edition, with three fiscal events (in the form of the ill-fated "Growth Plan", the 17 October 2022 statement and the recent Autumn Statement), as well as the appointment of no fewer than three Chancellors of the Exchequer.

In light of the current economic circumstances, together with planned spending cuts and tax rises, there is now huge pressure to recover money through closing the tax gap. It came as no surprise, therefore, that the recent Autumn Statement announced a package of measures to tackle tax avoidance, evasion and wider non-compliance, including further investment in HMRC staff (see 'Other developments' for further detail). We have already seen HMRC ramping up activity since the end of the pandemic and the latest announcements will inevitably see that trend accelerate further. Both individual and corporate taxpayers would be well-advised to check their tax position as soon as possible to prepare for any potential HMRC investigation into their tax affairs.

In this edition, we look at just a few of the areas in which HMRC are currently active, including a crackdown on R&D claims, a record increase in the number of football investigations, loan charge discovery assessments, and the latest series of HMRC nudge campaigns. We also cover a number of notable tax cases in the higher courts and other interesting procedural decisions, including a Court of Appeal decision that has important implications for the taxation of settlement payments.

About the team

With 14 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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In focus: taxation of settlement payments

In *HMRC v Murphy* [2022] EWCA Civ 1112, the Court of Appeal considered the taxable nature of settlement payments made in respect of a success fee and insurance premium. Despite not actually being received by the employee claimant under the settlement with their employer, those payments were treated as employment income for tax purposes. The decision has important implications for the structure and drafting of settlement agreements and the potential tax treatment of third-party costs, including amounts payable under damages-based agreements, insurance policies and other litigation funding arrangements - whether in the context of employment taxes or otherwise.

Background

Mr Murphy was one of a number of police officers who commenced a group litigation action against the Metropolitan Police Service (the "**Met**") in respect of unpaid overtime and certain other allowances. In order to fund the legal proceedings, the claimants entered into a damages-based agreement that provided for their legal advisers to be paid a success fee (calculated as a percentage of any court-awarded damages or settlement sum payable by the Met). In addition, the claimants took out after-the-event insurance against the risk of having to pay the Met's legal costs in case the claimants lost all or part of their claims.

In 2016, the parties entered into a settlement agreement pursuant to which the Met, without making any admission of liability, agreed to pay the following amounts to the claimants in full and final settlement of their claims:

— a "**Principal Settlement Sum**" of £4.2 million; and

— "**Agreed Costs**" (defined as the agreed legal costs and disbursements of the claimants' legal advisers),

together referred to under the settlement agreement as the "**Global Settlement Sum**".

The settlement agreement specifically provided that, other than the Agreed Costs, the parties would bear their own costs in relation to the dispute with the Met and the settlement agreement. Significantly, under the terms of the settlement agreement, the Agreed Costs were not defined to include the success fee or the insurance premium.

Instead, amounts in respect of the success fee and insurance premium were to be deducted from the Global Settlement Sum and paid directly by the Met to the claimants' legal advisers and insurer, respectively. The remaining balance of the Principal Settlement Sum was then stated as payable to the claimants on an apportioned basis and subject to deductions for PAYE and National Insurance Contributions ("**NICs**"). The Agreed Costs were payable without any such deductions.

The Met duly applied PAYE to the whole of Mr Murphy's apportioned share of the Principal Settlement Sum, including the amounts paid in respect of his share of the success fee and insurance premium (notwithstanding that those amounts were not actually paid to Mr Murphy). However, Mr Murphy filed his tax returns on the basis that the amounts paid in respect of the success fee and insurance were not taxable as employment income.

Section 62(2) of the Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**") defines "*earnings*" for the purpose of the employment income parts of that Act, so far as relevant, as follows:

> *(2) In those Parts "earnings", in relation to an employment, means –*
>
> *(a) any salary, wages or fee,*
>
> *(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or*
>
> *(c) anything else that constitutes an emolument of the employment.*

The dispute in this case concerned whether amounts paid in respect of either the success fee or the insurance premium constituted "*earnings*" within the meaning of section 62(2) ITEPA and were therefore taxable as employment income. The First-tier Tribunal (Tax Chamber) ("**FTT**") and Upper Tribunal (Tax and Chancery Chamber) ("**UT**") had reached opposing decisions before the case reached the Court of Appeal.

FTT's original decision

On appeal to the FTT, Mr Murphy argued that the amounts paid in respect of the success fee and insurance premium were not derived from his employment with the Met. It was common ground that the Agreed Costs were not so derived and therefore not taxable as earnings. However, the FTT noted that, under the terms of the settlement agreement, the Principal Settlement Sum did not include any element of costs. The Principal Settlement Sum constituted a payment in settlement of a claim for unpaid overtime and allowances, which it was accepted would have been taxable earnings if paid by the Met in the first place. The FTT held that the payment mechanics set out by the settlement agreement (whereby payments of the amounts paid in respect of the success fee and insurance premium were never received directly by Mr Murphy and the other claimants) made no difference to the character of the success fee or the insurance premium as part of the Principal Settlement Sum. On that basis, the FTT decided that the entirety of the Principal Settlement Sum (including the amounts paid in respect of the success fee and insurance premium) was derived from the employment with the Met and therefore taxable as employment income.

UT's reversal

It was common ground between the parties that the Principal Settlement Sum (including the amounts paid in respect of the success fee and insurance premium) could only be treated as "*earnings*" under section 62 ITEPA if it fell within sub-section (2)(b) (i.e., "*any…other profit… obtained by the employee*"). Although it was an amount in respect of unpaid overtime and allowances - and therefore no doubt salary or wages - it was a settlement payment and therefore not actually salary or wages. The UT decided that, even if the amounts paid in respect of the success fee or insurance premium could be regarded as derived from Mr Murphy's employment with the Met, the FTT had erred in not going on to consider whether such amounts should be regarded as "*profit*" for these purposes.

The UT held that the term "*profit*" in sub-section (2)(b) is a reference to net profit (rather than gross profit), and that the amounts paid in respect of the success fee and insurance premium should be deducted in the profit calculation on the basis that such payments were necessarily incurred to obtain the payment derived from the employment. It made no difference to the UT that the claimants chose to fund the litigation by means of a damages-based agreement. On that basis, the UT concluded that Mr Murphy had not made a "*profit*" for the purposes of section 62(2)(b) ITEPA to the extent that the Principal Settlement Sum was paid in discharge of the success fee and insurance premium. Those amounts could not therefore be treated as "*earnings*".

Court of Appeal

The Court of Appeal decided that none of the relevant case law authorities provided support for the net profit approach taken by the UT, arguing that this made no sense given that the statutory framework under ITEPA allows for specific deductions from earnings.

In determining whether a payment by an employer to its employee constitutes "*earnings*" from employment, the Court of Appeal held that the sole question is whether the payment is a reward for their services as an employee. If the employee is obliged to incur an expense out of their own pocket in order to carry out their duties and is subsequently reimbursed by the employer, the employee is not being rewarded for the provision of their services. Similarly, if the employer reimburses for a loss incurred by its employee outside the context of their employment (not by way of remuneration for their services but under some entirely separate arrangement), the payment cannot constitute "*earnings*", even if the recipient has to be an employee to take advantage of that arrangement. Conversely, if a financial benefit is conferred on the employee in return

for their services, the whole of that benefit is treated as taxable income and subject only to the deductions specifically permitted by statute.

The Court of Appeal found that the whole of the Principal Settlement Sum represented a payment in respect of sums alleged to have fallen due under employment contracts, out of which certain liabilities incurred by the claimants to their legal advisers and insurer were to be settled (i.e., the success fee and the insurance premium). Moreover, the settlement agreement made clear that the claimants remained responsible for payment of those liabilities.

According to the Court of Appeal, the Agreed Costs were not a reward for Mr Murphy's services as an employee because the settlement agreement accounted for such costs entirely separately from the compensation element of the settlement payment. The success fee and insurance premium, on the other hand, were treated differently by the settlement agreement and paid directly from the Principal Settlement Sum. The fact that the settlement agreement provided that the success fee and insurance premium would be paid directly by the Met to the legal advisers and insurer, respectively, made no difference to the character of those payments.

Action points

A key point of interest in this decision is the distinction drawn between the Agreed Costs, on the one hand, and the success fee and insurance premium, on the other. The Court of Appeal's decision seems to have relied at least to some extent on the drafting of the settlement agreement and structuring of the relevant payments. The judge argued that, lest that gave rise to accusations of unfairness, the question of whether a payment is taxable remains a matter of substance over form. In this case, the parties had deliberately structured the payments so that the success fee and insurance premium were treated as payable out of money which represented taxable income, whereas other legal costs had been treated differently.

The decision clearly has important implications for settlement agreements and the potential tax treatment of third-party costs, including amounts payable under damages-based agreements, insurance policies and other litigation funding arrangements – whether in the context of employment taxes or otherwise. Careful consideration should be given to the underlying character of payments, including how such payments are accounted for and structured, and not just to their labelling. The Court of Appeal's decision makes clear that simply diverting payments away from claimants will be insufficient. Parties will clearly also want to factor in the question of any necessary tax gross-up at an early stage in their negotiations.

In focus: HMRC launch record number of football investigations

The huge sums paid in respect of elite football player salaries/transfers means there is inevitably the potential for significant amounts of unpaid tax. Unsurprisingly, therefore, professional football has long been an area of interest for HMRC and published figures indicate that there is now an unprecedented level of scrutiny over the industry's tax arrangements. According to media reports, HMRC opened investigations into the tax affairs of a record 329 professional football players, including Premier League players, in 2021/22 (more than three times the number of investigations opened in the previous year), together with 31 clubs and 91 agents. Below we look at the reasons behind the surge of activity and what action those in the industry should take.

Agent fees

A key area of focus for HMRC's investigations is that of fees paid to football agents. For example, in contract renegotiations of current players or negotiations to sign new players, the same agent may represent both the club and the player (referred to as "dual representation"). The most recent data published by the FA suggests that dual representation was present in the majority of Premier League contract negotiations.

Where there is dual representation, the club will make a payment to the agent in respect of the services provided by the agent to the club, but may also make a payment to the agent on behalf of the player. Payments made by a club on behalf of the player are taxable as employment income of the player. In such cases, therefore, it may be necessary to split the total payment made by the club to the agent in order to reflect the extent to which such payment is treated as being attributable to services made by the agent to the club and the player, respectively.

Clubs and players may have historically adopted a default 50:50 split to determine the taxable benefit for the player. However, HMRC published new guidance last year on the tax treatment of payments to agents. In a departure from previous practice, HMRC will not automatically accept a 50:50 split of an agent's fees between the club and the player. Instead, the split of the agent's fees must reflect the substance of the commercial agreement and detailed records will need to be kept.

Image rights

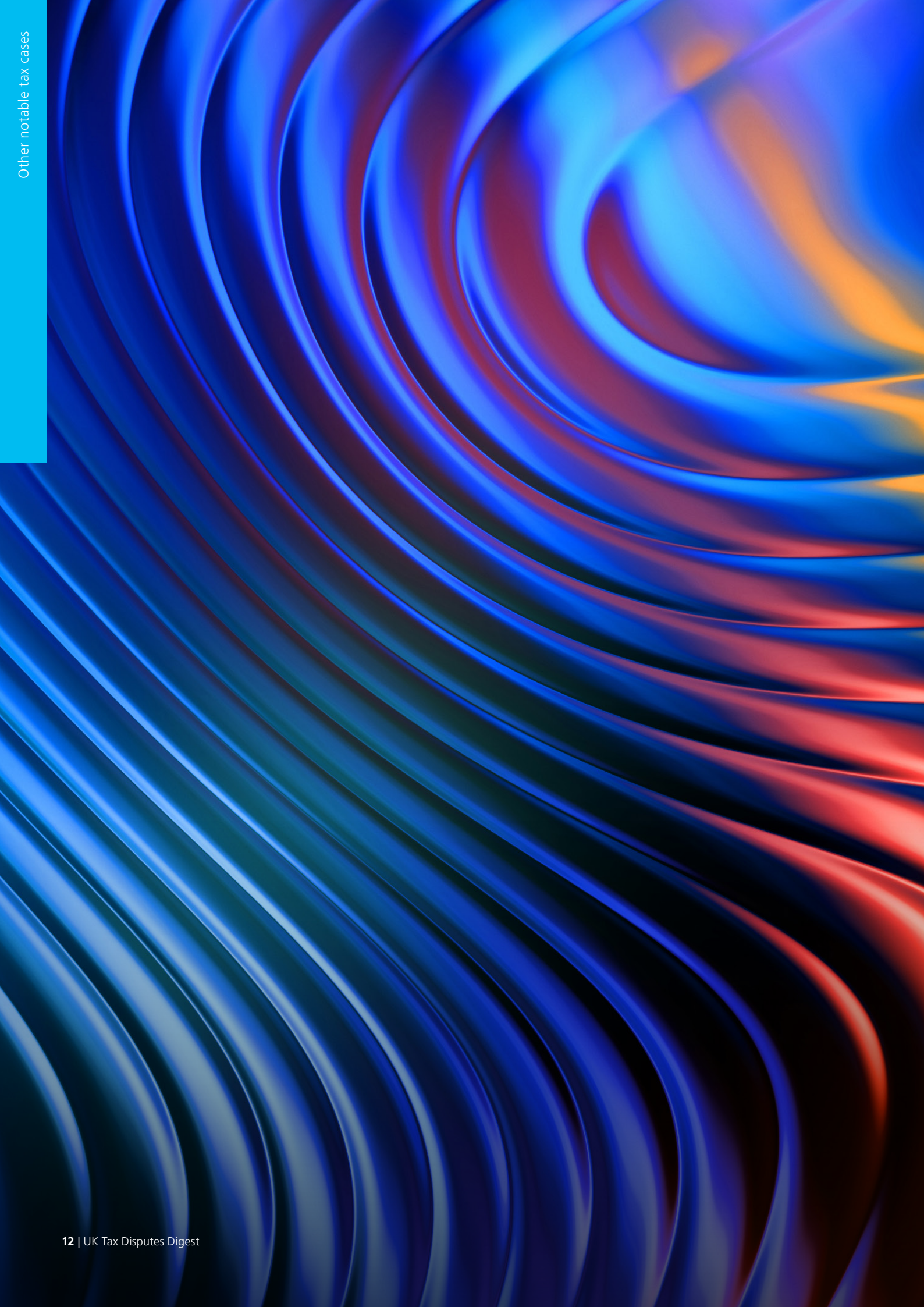
Another area of focus for HMRC is that of arrangements around the so-called "image rights" of players (i.e., a player's name, image and other characteristics). For example, players can potentially reduce their personal tax liability by transferring image rights to personal service companies, such that any amounts received in respect of those image rights will be taxable at the lower rate of corporation tax (or potentially even lower if the company is offshore). At the same time, football clubs making payments to those companies in respect of the image rights could potentially benefit from reduced employment tax liabilities. HMRC may investigate where it believes that such payments made by clubs actually represent disguised employment income (for example, where clubs are not exploiting image rights or are overpaying players with limited brand recognition).

Action points

Any clubs or players who receive a notice of enquiry or other correspondence from HMRC should seek professional advice as soon as possible.

Given the surge in the number of investigations, clubs or players who may be concerned about becoming the target of an investigation (for example, where a 50:50 split has been adopted in respect of payments made to agents in dual representation cases or where parties have entered into arrangements concerning image rights) would be well-advised to review their tax position. Where issues are identified, affected persons may wish to make a voluntary disclosure to HMRC in order to mitigate any penalties. Even if a review determines that the existing arrangements are appropriate, this exercise could help to defend the tax position adopted in case HMRC decide to open an investigation in the future.

Those in the industry should also consider taking measures to prevent the risk of future problems arising. For example, where there is dual representation, contemporaneous evidence should be kept of the agent's work for the club and the player, as well as the details of any discussions of how the agent's fee and its split were determined (including copies of telephone/meeting notes, emails and other relevant supporting evidence). For completeness, we note that, although agent fees and image rights are areas of focus for current HMRC investigations, HMRC investigations may not be limited to these issues.



Other notable tax cases

Burlington Loan Management DAC v HMRC [2022] UKFTT 00290 (TC)

The FTT considered whether the appellant (an Irish resident company), which had paid for the assignment of a debt claim, had a "*main purpose*" of taking advantage of Article 12(1) (interest) of the UK/Republic of Ireland Double Tax Treaty. If, as HMRC asserted, it did have such a "*main purpose*", HMRC would have been correct in refusing to repay the income tax withheld by the debtor (a UK resident company) to the appellant by virtue of Article 12(5) of the treaty. HMRC were unsuccessful in their argument that such a "*main purpose*" was demonstrated by the fact that the consideration paid by the appellant for the debt reflected the appellant's ability to claim for relief under the treaty (an entitlement which the seller of the debt claim did not have).

Embiricos v HMRC [2022] EWCA Civ 3

The Supreme Court has refused the taxpayer's application for permission to appeal in *Embiricos v HMRC*, with the result that the Court of Appeal's judgment stands as binding precedent. The Court of Appeal held that HMRC had no power to issue a partial closure notice regarding 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. Going forward, the practical outcome is that taxpayers will have to provide details of their foreign income and gains to HMRC before a partial closure notice may be issued. Only then will it become possible for the taxpayer to appeal HMRC's decision to the FTT. This will be of particular interest to taxpayers who are, or may in future be, subject to a domicile enquiry.

HMRC v Aozora GMAC Investment Limited [2022] UKUT 00258 (TCC)

The UT considered HMRC's appeal in this case concerning one of the circumstances in which unilateral relief by way of credit may be denied. The taxpayer had suffered US withholding tax on intragroup interest payments and, as it was not entitled to relief under the limitation of benefits provision (article 23) in the US/UK Double Tax Treaty, applied for unilateral relief by way of credit. HMRC argued that section 793A(3) of the Income and Corporation Taxes Act 1988 (now section 11(3) of the Taxation (International and Other Provisions) Act 2010) meant that the denial of treaty relief similarly prevented the taxpayer from claiming unilateral relief. In a decision which went back to the basics of statutory interpretation, the UT held that section 793A(3) did *not* deny the taxpayer relief as article 23 of the US/UK Double Tax Treaty did not expressly set out the circumstances in which credit relief was *not* available (instead setting out the circumstances in which the benefits of the treaty *were* available).

DCM (Optical Holdings) Ltd v HMRC [2022] UKSC 26

The underlying dispute in this case concerned the well-trodden ground of apportionment of output VAT and recovery of input VAT on supplies by partially-exempt persons. However, it was the statutory provisions relating to VAT assessments which were before the Supreme Court. In particular, the judgment concludes that the time limit for the one-year time limit in section 73 of the Value Added Tax Act 1994 ("**VATA**") only begins when HMRC obtains the *last* of the evidence of facts which are sufficient to justify their assessment. Additionally, the taxpayer lost in its argument that HMRC had no power to make reductions in the input tax it had claimed, with the court determining that it is implicit in the legislation that the obligation for HMRC to pay a VAT credit under section 25(3) VATA only arises once the credit is due.

Bluecrest Capital Management (UK) LLP v HMRC [2022] UKFTT 00204 (TC)

This decision marked the first time that the courts have considered the salaried member rules, which were introduced in 2014 to align the income tax and NICs treatment of LLP members with employees, in situations where those LLP members are engaged on terms similar to employees rather than traditional partners. Of particular significance is the FTT's finding that the statutory phrase "*significant influence over the affairs of the partnership*" can include both managerial and financial influence, and that the "*significant influence*" can be over one or more aspects of the affairs of the partnership (rather than needing to be over the partnership generally). This finding may be particularly welcome to members of businesses commonly structured as LLPs.

BCM Cayman LP (1) and Bluecrest Capital Management Cayman Limited (2) v HMRC [2022] UKUT 00198 (TCC)

This lengthy decision from the UT goes to the heart of some of the key principles of partnership taxation, namely allocation of profits and interest deductibility, specifically in relation to tiered partnership structures. In a harsh result for the taxpayer, the UT held that the general partner of the "upper" partnership was the only partner in the underlying UK LLP (i.e., the "lower" partnership) and as such was subject to UK tax on the entirety of the profit allocation from the lower partnership to the upper partnership – despite the general partner's *de minimis* share in that upper partnership. Additionally, the UT held that the general partner's borrowing costs (for acquiring its interest in the upper partnership) were incurred for the purposes of the general partner's investment in the upper partnership, rather than the UK LLP's trade, which was carried on by the general partner by virtue of being a partner in the upper partnership.

Ventgrove Ltd v Kuehne+Nagel Ltd [2022] CSIH 40

The Inner House of the Court of Session ("**CSIH**") has held that a tenant was required to pay VAT on the payment of a break fee and that there was no legitimate expectation to the contrary. Based on the decisions in *Lubbock Fine & Co v Customs & Excise Commissioners [1994] QB 571, MEO v Autoridade Tributária e Aduaneira* (Case C-295/17) and *Vodafone Portugal v Autoridade Tributária e Aduaneira* (Case C-43/19), the CSIH decided that, where there is a transaction which would be subject to tax, changes in the contractual relationship between landlord and tenant ought also to be regarded as subject to tax. Therefore, where property has been opted to tax (as it had in this case), termination payments are within the scope of VAT as there is a taxable supply of land, but where there has been no option to tax, termination payments will not be within the scope of VAT as it is an exempt supply. The CSIH dismissed the tenant's argument that there was a legitimate expectation that VAT would not be chargeable based on HMRC's statements in the case of *Lloyds Bank plc v C&E Commrs* (LON 95/2424).

Gallaher Ltd v HMRC (Case C-707/20)

The Advocate General to the Court of Justice of the European Union ("**CJEU**") has opined that UK rules on intra-group asset transfers are not incompatible with the EU principles of freedom of establishment or free movement of capital. In this case, the taxpayer had transferred shares and intangible assets from UK tax resident companies to group companies resident outside the UK. Under UK legislation, that triggered an immediate tax charge, whereas an equivalent transfer between UK group companies would have benefitted from relief. The Advocate General opined that in these circumstances the difference in treatment for cross-border group transfers of assets was justified by the need to maintain a "*balanced allocation of taxing powers*".

The Quentin Skinner 2015 Settlement L and others v HMRC [2022] EWCA Civ 1222

The Court of Appeal has overturned a UT decision to disallow the beneficiaries' claims for entrepreneurs' relief (now known as business asset disposal relief) and instead reinstated the original decision made by the FTT. The Court of Appeal agreed with the FTT's judgment that, in order to qualify for the relief, a qualifying beneficiary must only hold an interest in possession under the trust at the time of the trustees' disposal of the business assets (in this case, the assets were shares). The Court of Appeal held that the relevant legislation strongly pointed away from the idea that a beneficiary must have an interest in possession for any minimum period (as argued by HMRC). This decision may provide individuals with more latitude when making a disposal of shares in their personal company to ensure the disposals are made in the most advantageous way, without a minimum period of ownership.

Altrad Services Ltd and another v HMRC [2022] UKUT 185 (TCC)

In an unusual decision, the UT decided that the taxpayers were entitled to capital allowances created through an artificial series of transactions. The FTT had determined there to be a lack of commercial purpose for the transactions such that there had been no "*real world*" disposal. The UT reversed the decision, acknowledging that some may find it "*surprising*" that an artificial series of transactions, devoid of business purpose and only effected to achieve a "*magical*" increase in capital allowances, should survive a *Ramsay* argument. However, the UT emphasised that the conclusion was based on the specific *Ramsay* argument put forward by HMRC (suggesting that a different argument may well have been successful). The case is useful in emphasising that the courts may be willing to limit HMRC's use of the *Ramsay* principle as a catch-all when facing avoidance schemes without also presenting a strong technical argument. It remains to be seen if HMRC will appeal the decision.

Szef Krajowej Administracji Skarbowej v O Fundusz Inwestycyjny Zamkniety reprezentowany przez OSA (Case C-250/21)

The CJEU found that the services provided by a sub-participant under a sub-participation agreement (which consisted of making available to the originator of credit a financial contribution in exchange for the payment of the proceeds from the receivables specified in that agreement, those receivables remaining in the assets of the originator) fell within the concept of "*granting of credit*", thereby benefiting from Article 135(1)(b) of the

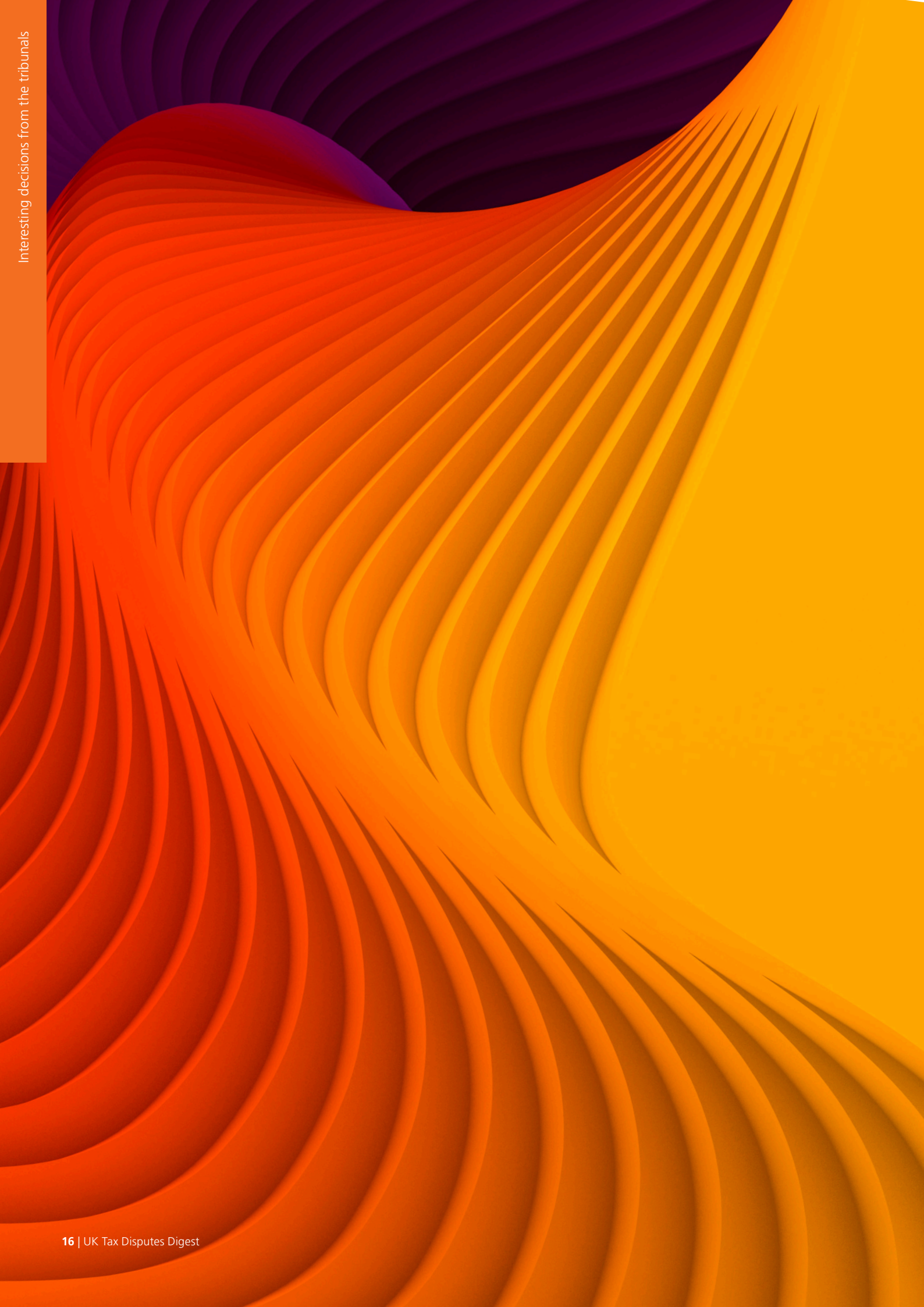
Principal VAT directive, which requires Member States to exempt the granting of credit from the scope of VAT.

Emerchantpay Limited v HMRC [2022] UKFTT 00334 (TC)

The FTT held that the intra-group supply from the operational group company and the contracting and trading entity of the group of the necessary services to allow the trading entity to act as Payment Services Provider could benefit from the exemption for intermediary services relating to the issue, transfer or receipt of, or any dealing with money or the payment of money under Group 5 of Schedule 9 VATA. The FTT found that the economic reality was fundamental to the analysis, so even though the transfer pricing agreement between the entities failed to mention certain services, that was not fatal to the analysis.

Intelligent Money Limited v HMRC [2022] UKFTT 148 (TC)

The FTT held that, whilst the provision of a self-invested personal pension ("**SIPP**") meets the *Prudential* and *Fuji* definitions of what constitutes insurance, the taxpayer could not rely on HMRC guidance stating anything that met these tests would benefit from the exemption from VAT for an insurance transaction. The FTT distinguished remunerated services relating to SIPPs from an insurance transaction on the basis that the taxpayer took on no risk premium, which has been shown to be a determining factor in EU case law. The annual fees paid to the taxpayer were for the provision of services, with no risk premium, and the taxpayer did not need to accumulate capital out of which to pay contracted benefits, and all funds paid out at all times remained those of the SIPP holder.



Interesting decisions from the tribunals

FTT partially grants journalist's request for disclosure of court documents

In *Bouncylagoon Limited and Others in the VAT Umbrella Appeals v HMRC* [2022] UKFTT 361 (TC), the FTT considered a third-party application made by a journalist for electronic copies of a case management hearing bundle and the parties' skeleton arguments.

Background

HMRC are subject to a general duty under tax and human rights legislation to keep information about a person's tax affairs private and confidential. For example, section 18 of the Commissioners for Revenue and Customs Act 2005 legislates to prevent HMRC officials from disclosing certain information held by HMRC and article 8 of the European Convention on Human Rights ("**ECHR**") provides individuals with a right to privacy.

However, strict confidentiality about a taxpayer's affairs does not extend to litigation proceedings. While it is possible for tax cases to be heard in private and for decisions to be anonymised, such cases are rare. The general rule is that tax cases are in the public domain. In *Cape Intermediate Holdings Ltd v Dring (for and on behalf of Asbestos Victims Support Groups Forum UK)* [2019] UKSC 38, the Supreme Court confirmed that the principle of open justice applies to all courts and tribunals, and that all courts and tribunals (including the FTT) have an inherent jurisdiction to determine what that principle requires in terms of access to information placed before it.

In *Bouncylagoon*, a remote case management hearing took place on 28 September 2022 for the purpose of selecting lead cases and determining directions for proceedings involving over 18,000 appellants. Broadly, HMRC considered that the appellants were participants in a contrived structure relating to VAT with the purpose of defrauding HMRC.

In line with the general rule that tax cases should be in the public domain, prior notice of the case management hearing had been published and interested members of the public were invited to observe remotely. One such person was BBC journalist Anna Meisel who, shortly following the hearing, made an application for electronic copies of the case management hearing bundle and the parties' skeleton arguments. The taxpayers' representatives objected on the basis that the requested information went beyond the level of detail discussed at the hearing and that Ms Meisel had not provided any reasons for her application beyond stating that she was a journalist. HMRC, on the other hand, raised no objection.

Decision

The FTT referred to the decision in *Cider of Sweden Limited v HMRC* [2022] UKFTT 76 (TC), which also involved an application by a third party for disclosure of information (although in that case, the application was made before there had been any hearing and no hearing was even imminent). In *Cider of Sweden*, Judge Poole of the FTT had set out the principles to be derived from the Supreme Court's decision in *Cape*. By reference to those principles, the FTT in *Bouncylagoon* set out a three-stage approach for third-party disclosure applications:

1. the FTT must consider whether disclosure will further the principle of open justice;
2. the FTT must conduct a fact-specific balancing exercise, weighing the value of advancing the principle of open justice against any risk of harm to maintenance of an effective judicial process or the legitimate interests of others; and
3. the FTT must consider the practicalities and proportionality of granting the application.

In relation to the skeleton arguments, the FTT decided that Ms Meisel would struggle to properly understand the submissions and the judge's comments at the case management hearing without sight of these documents and that disclosure of such documents would therefore further the principle of open justice (i.e., stage (1) above). The judge also noted that it was not necessary for Ms Meisel to do more than indicate that the information was sought for journalistic purposes. The FTT held that stages (2) and (3) above were also satisfied on the facts, and therefore granted the application in respect of the skeleton arguments.

However, the FTT refused the application in respect of the hearing bundle, which was not referenced in detail at the case management hearing and, given the selection of lead cases in the proceedings, also contained information on other cases that may never become the subject of a public hearing. On that basis, disclosure of the hearing bundle would not further the principle of open justice.

Comment

All taxpayers now face an increasingly complex and hostile environment, with unprecedented levels of scrutiny and public interest over their tax affairs. Whereas discussion of cases before the FTT has often been limited to legal and accountancy circles, taxpayers should expect a growing level of public interest in these cases and, inevitably, disclosure applications from journalists and other interested third parties.

This particular decision can be distinguished from the decision in *Cider of Sweden* on the basis of timing, where the disclosure application in the latter was made too early in order to be treated as furthering the principle of open justice. The specific circumstances of any disclosure application should therefore be considered carefully to understand which of the two decisions might more closely apply. Even if the facts more closely resemble those in *Bouncylagoon*, it still may be worth raising an objection – previous decisions of the FTT are not strictly binding and a third party (depending on its resources) may well be put off by the prospect of incurring legal costs needed to sustain a disclosure application.

Deliberate penalties do not require proof of dishonesty

In *CF Booth Limited v HMRC* [2022] UKUT 00217 (TCC), the UT upheld an earlier decision of the FTT to strike out most of the taxpayer's appeal against a deliberate penalty on the basis that it constituted an abuse of process and had no realistic prospect of success.

Background

Schedule 24 to the Finance Act 2007 ("**Schedule 24**") provides for a penalty to be assessed where a taxpayer carelessly or deliberately provides HMRC with an inaccurate document (such as an incorrect tax return) that leads to an understatement of liability or overstatement of repayment. The legislation recognises different degrees of taxpayer culpability (i.e., careless or deliberate) to decide the amount of penalty to be assessed. Reductions in penalties can also be given based on the quality and timing of taxpayer disclosure or, where applicable, for any special circumstances.

In *CF Booth*, the taxpayer had been issued with a penalty assessment on the basis that its VAT returns for the periods in question contained deliberate inaccuracies. The background to that penalty assessment was that, in an earlier decision of the FTT ([2017] UKFTT 813 (TC)), it was held that the taxpayer knew (or, in the alternative, should have known) that a number of transactions to which it was a party were connected to the fraudulent evasion of VAT.

Despite not appealing the FTT's decision regarding the underlying VAT assessment, the taxpayer decided nevertheless to appeal the penalty assessment, including on the basis that the inaccuracies in its VAT returns were not "*deliberate*" for the purposes of Schedule 24. HMRC applied to the FTT for most of the taxpayer's grounds of appeal to be struck out on the basis that they were an abuse of process (effectively re-litigating matters that had already been determined) or were otherwise unarguable. The FTT agreed to the strike out, leaving the taxpayer only able to argue for further reductions in the amount of the deliberate penalty based on the quality of taxpayer disclosure.

Decision

The taxpayer's appeal against the FTT's strike out decision included, *inter alia*, the argument that HMRC needed to prove dishonesty in order for there to be "*deliberate*" conduct for the purposes of Schedule 24 (such that the earlier findings of the FTT were not sufficient).

The UT rejected that argument, reaffirming the well-known decision in *Auxilium Project Management v HMRC* [2016] 0240 (TC) that a deliberate accuracy under Schedule 24 occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. In *HMRC v Tooth* [2021] UKSC 17, the Supreme Court had also considered the meaning of a "*deliberate*" inaccuracy (albeit in the context of discovery assessment legislation rather than penalties), deciding that this required an "*intention to mislead [HMRC] on the part of the taxpayer as to the truth of the relevant statement or, perhaps… recklessness as to whether it would do so*". The UT decided that nothing in the Supreme Court's decision called into question the test set out in *Auxilium* in respect of Schedule 24 penalties.

The taxpayer also argued that HMRC needed to prove that the person who actually completed and filed the VAT returns had knowledge that they were inaccurate. The UT dismissed this, confirming that it is not necessary to attribute knowledge to a particular individual (or else a penalty could simply be avoided by keeping the person completing the returns in the dark as to the Appellant's knowledge that its transactions were connected with the fraudulent evasion of VAT). The FTT had already found that the taxpayer knew before submitting the returns that the transactions were connected with fraud and that finding had not been appealed.

The UT also held that Article 6 ECHR protection did not prevent the FTT from striking out the appeal. A penalty assessment constitutes a criminal charge for the purposes of Article 6, even though for domestic law purposes it is treated as a civil matter. The UT was satisfied that that the taxpayer had received a fair trial and that the FTT's procedural rules did not infringe Article 6.

Comment

The UT's decision is important in confirming the correct test for deliberate conduct for the purposes of Schedule 24 following the Supreme Court's related decision in *Tooth* and, in particular, that no element of dishonesty is required.

The UT's decision is ultimately not surprising given the taxpayer had not appealed the FTT's earlier factual findings. When litigating a tax assessment (and certainly before making any decision whether to appeal an adverse decision), taxpayers should ensure that proper consideration is also given to any subsequent penalty proceedings that may arise and the consequential impact that any adverse decision may have.

VAT appeal valid despite no payment of tax or hardship application

In *SNM Pipelines Limited v HMRC* [2022] UKFTT 231 (TC), the FTT held that the taxpayer's notice of appeal was valid, notwithstanding the fact that the disputed amount of VAT had not been paid and that a hardship application had not been made.

Background

If a taxpayer disagrees with a decision made by HMRC, such as a notice of assessment, in most cases a challenge may be ultimately brought by way of appeal to the FTT. There are strict time limits for lodging appeals (usually 30 days) and late appeals will only be accepted in limited circumstances.

In contrast to the position for direct taxes, VAT legislation provides that an appeal will not be "*entertained*" unless either: (i) the amount of disputed tax has been paid; or (ii) the taxpayer successfully demonstrates on application to HMRC (or, failing that, the FTT) that paying the disputed amount would cause it to suffer hardship.

Following a missing trader investigation, HMRC decided that the taxpayer was not entitled to certain repayments of input tax and issued assessments for approximately £312,000. In August 2017, the taxpayer's representatives submitted a notice of appeal within the prescribed 30-day time limit. However, the FTT returned the notice of appeal a few days later on the basis that the disputed tax had not been paid and no hardship application had been made. The notice of appeal was quickly re-submitted (outside the 30-day time limit) but again returned for the same reason. Unfortunately, the FTT used an incorrect email address and the returned notice of appeal was never received by the taxpayer's representatives.

That mistake was not discovered until around August 2020, when HMRC's debt collection team tried to recover the disputed VAT. Having heard nothing further from HMRC or the FTT in relation to the dispute in the three years since re-submitting its notice of appeal, the taxpayer had apparently assumed that its appeal had been successful.

In October 2020, the taxpayer's new representatives submitted another notice of appeal (together with an application for permission to appeal out of time) but this was yet again returned on the basis that the disputed tax had still not been paid nor any hardship application made. In December 2020, a hardship application was finally made and a subsequent notice of appeal was duly accepted by the FTT (at the fourth attempt). HMRC accepted the hardship application but nevertheless filed an objection to the late appeal.

Decision

The FTT determined that previous decisions concerning the meaning of the word "*entertained*", including that of the Inner House of the Court of Session in *HMCE v Hubbard Foundation Scotland* [1981] STC 593, suggested that a tribunal only begins to "*entertain*" an appeal when it is listed for hearing (rather than when the tribunal receives/acknowledges a notice of appeal). On that basis, the fact that an appeal cannot be "*entertained*" should not mean that it has not been validly made. However, such decisions were made in the context of the old procedural rules of the VAT Tribunal, a predecessor of the FTT. The question was therefore whether the current procedural rules of the FTT (the "FTT Rules") produced a different answer.

Rule 22 of the FTT Rules applies in respect of hardship applications. Rule 22(1) refers to an "*appeal proceeding*", which the FTT decided is essentially synonymous with the term "*entertained*" used in VAT legislation. Although Rule 22(2) refers to certain steps being required when "*starting proceedings*", the FTT held that this should be interpreted so as to be consistent with VAT legislation and Rule 22(1). On that basis, the FTT decided that the original notice of appeal was validly made in 2017 and, given HMRC had now accepted the hardship application, that the appeal should proceed towards a hearing.

Comment

In practice, the taxpayer's victory in this case may be of limited wider benefit in VAT disputes. Even if a notice of appeal were lodged without the taxpayer paying the tax or making a hardship application, the appeal could not proceed beyond that point without one of those steps being taken (and the appeal would be struck out if the taxpayer did not do so within a reasonable period of time).

The case highlights the importance of making appeals within the time allowed and following all necessary procedural steps. It is not clear, for example, why it took over three years to make a hardship application in this case (given an application was later accepted), despite notices of appeal being repeatedly rejected on that basis and why no steps were taken in that significant period of time to check on the status of the appeal. Commenting on those points, the judge in this case made clear that he would have had no hesitation in refusing permission for a late appeal if he had not concluded that the 2017 appeal was validly made. Given the strict time limits for commencing any form of tax litigation, it is critical to seek specialist legal advice as soon as any potential dispute arises.

ATED late filing penalties can be charged retrospectively

In *Priory London Ltd v HMRC; HMRC v Jocoguma Properties Ltd* [2022] UKUT 00225 (TCC), the UT decided that daily penalties for failure to file annual tax on enveloped dwellings ("**ATED**") returns can be charged retrospectively.

Background

Schedule 55 of the Finance Act 2009 ("**FA 2009**") provides for late-filing penalties where taxpayers fail to properly file ATED returns. Where an ATED return is more than three months late, HMRC can issue a notice in order to charge a £10 penalty for each day that the return remains outstanding (up to a maximum of 90 days starting with a date specified by HMRC in that notice). The legislation expressly states that the date specified in such notice (i.e., the date from which daily penalties will begin) may be earlier than the date on which the notice is given. However, the correct interpretation of such provision has been unclear due to the FTT having reached opposite conclusions in two recent decisions.

In both *Jocoguma Properties Ltd v HMRC* ([2021] UKFTT 0020 (TC)) and *Priory London Ltd v HMRC* ([2021] UKFTT 0282 (TC)), the taxpayer had submitted ATED returns late and HMRC charged an initial fixed penalty of £100. In the notices charging those fixed penalties, HMRC stated that daily penalties would also be charged if the returns were more than three months late, starting from a date that pre-dated the date of the notice by several months. HMRC subsequently issued daily penalties up to the maximum limit (on the basis that a period of 90 days had therefore already passed).

Although the taxpayer's appeal in *Priory* was dismissed, a differently constituted FTT upheld the appeal in *Jocoguma*, deciding that the notice specifying the date from which daily penalties would become payable could not be issued on a retrospective basis. As the taxpayer's ATED return in that case had already been filed by the time such notice was issued, no daily penalties should therefore be payable. In reaching that decision, the FTT had followed the decision in *Heacham Holidays Ltd v HMRC* [2020] UKFTT 406, which essentially held that the purpose of the penalty notice was to give a warning to a taxpayer that they will be liable for a daily penalty if their failure to file a return continues during the following 90-day period and therefore on a purposive construction the notice must be given before the start of that 90-day period. In *Heacham*, the judge had in turn relied on the decisions of both the UT and the Court of Appeal in *Donaldson v HMRC* ([2014] UKUT 536 (TCC); [2016] EWCA Civ 761). The FTT in *Priory* had also relied on *Heacham*, but concluded that such case had been wrongly decided.

Both cases were appealed and heard together before the UT.

Decision

The UT followed the decision in *Priory* and held that HMRC are able to issue notices retrospectively, largely for the reasons set out by the judge in that case. The decision in *Donaldson* had to be read in context. *Donaldson* concerned the late filing of an income tax return, whereas *Jocoguma* and *Priory* both concerned ATED returns. Whilst HMRC are generally aware of a taxpayer's obligation to file an income tax return (and can therefore issue a notice prior to the taxpayer incurring potential daily penalties), HMRC cannot know that an ATED return is due at all until it is submitted.

Comment

The UT's decision brings helpful clarity to a previously confused position. It is now clear that HMRC can issue ATED daily penalties for periods prior to the date on which the penalty notice itself is issued. It is important to emphasise that this decision is specific to ATED returns, where HMRC will be unaware of the taxpayer's obligation to file a return until the return has actually been filed. The outcome will be different for tax returns which HMRC are able to anticipate being due, such as income tax returns.

Football club fails to prove that HMRC were out of time to make VAT assessment

In *Nottingham Forest Football Club Limited v HMRC* [2022] UKFTT 00305 (TC), the FTT held that the taxpayer had failed to discharge the required burden of proof that a VAT assessment was time-barred.

Background

Generally, the maximum time limit for HMRC to make an assessment to VAT is four years after the end of the relevant VAT period (or 20 years for cases involving "*deliberate*" behaviour). However, section 73(6)(b) VATA provides that, in addition, a VAT assessment must not be made after the later of either:

(a) two years after the end of the relevant VAT period; or

(b) one year after evidence of facts, sufficient in the opinion of HMRC to justify the making of the assessment, comes to their knowledge (the "**knowledge of the facts test**").

The sole issue in dispute before the FTT in this case was when the knowledge of the facts test was satisfied in order to determine whether the VAT assessment was time-barred.

On 20 April 2018, an HMRC officer visited the taxpayer to examine certain invoices and to download general ledger data. A back-up memory stick containing data from the taxpayer's previous Sage accounting system was later collected by the same officer on 9 May 2018. Following further enquiries and correspondence, HMRC subsequently issued a VAT assessment on 29 April 2019.

The taxpayer argued that HMRC's assessment relied on information derived from the data collected on 20 April 2018, and that HMRC therefore had all the information needed to make an assessment on that date. On that basis, the one-year period prescribed by the knowledge of the facts test should have expired on 20 April 2019 and the assessment issued on 29 April 2019 should be time-barred. HMRC argued that the knowledge of the facts test was only satisfied (at the earliest) at the later date of 9 May 2018, meaning that the assessment would remain valid.

Decision

The FTT referred to the decision in *Pegasus Birds v Customs and Excise Commissioners* [1999] STC 95, in which Dyson J sets out the legal principles to be applied where s73(6)(b) VATA is concerned and, in particular, that the burden of proof rests on the taxpayer to demonstrate that an assessment was made outside the time limit prescribed under that provision.

Significantly, the taxpayer did not provide any witness evidence to clarify what data was in the possession of the HMRC officer at the relevant times. The FTT noted that this was "*conspicuous*" and that the remaining documentary evidence was insufficient to demonstrate that the Sage data collected by HMRC on 9 May 2018 was irrelevant to the officer's knowledge of the facts before that date. On that basis, the FTT was left with no choice but to rule that the taxpayer had failed to discharge the burden of proof on the balance of probabilities and the appeal was dismissed.

Comment

The FTT's decision highlights that the burden is on the taxpayer to show that an assessment was made outside the one-year time limit under section 73(6)(b) VATA. Taxpayers seeking to rely on this time limit should ensure that all relevant evidence is gathered and presented to the Tribunal, and take advice before embarking on costly litigation as to whether any such evidence is likely to be sufficient if there are no other grounds of appeal.

FTT directs HMRC to close enquiry despite outstanding information requests

In *Newpier Charity Limited v HMRC* [2022] UKFTT 373 (TC), the FTT directed that HMRC should close their enquiry into the tax return of a charity, despite the fact that many of HMRC's requests for information remained outstanding.

Background

A self-assessment enquiry is only considered formally concluded when HMRC issue a closure notice. However, the legislation does not provide a specific time limit for HMRC to do so, meaning this is often a key area of disagreement with taxpayers.

If a taxpayer considers that HMRC already have sufficient information to conclude an enquiry, it may apply to the FTT for a direction requiring HMRC to issue a closure notice within a specified period. The burden is then on HMRC to demonstrate, on the balance of probabilities, that there are reasonable grounds not to do so. If a closure notice is issued, the taxpayer would have the ability to appeal an unfavourable conclusion to the FTT. Closure notices therefore offer an important protection for taxpayers against inappropriately protracted enquiries.

In this case, HMRC had opened an enquiry into a charity's corporation tax return for the accounting period ended 30 June 2017 and were particularly interested in certain payments totalling £821,000 on which charity tax relief had been claimed. Broadly, charity tax relief applies in respect of income and gains only where used wholly for charitable purposes. HMRC's investigation had found that income treated as subject to relief had been apparently paid to connected persons and so had requested various information relating to the identity of the recipients, as well as the nature and purpose of the payments. A number of their requests for information remained outstanding, which HMRC argued meant that the enquiry could not be closed.

However, the taxpayer argued that the outstanding information requested by HMRC was no longer available (or had otherwise never existed) and, in any event, was irrelevant as HMRC already had sufficient information to reach a conclusion. Some of the information requested related to transactions more than 20 years earlier and the taxpayer submitted that it would be unreasonable to expect information of that age to be available. It was also pointed out that, as the maximum possible time limit for HMRC assessments would be 20 years, any information outside that time limit could not be reasonably required.

Decision

The FTT noted that, based on the information available, a number of HMRC's concerns regarding the legitimacy of the taxpayer's claim to charity tax relief appeared to be reasonable. However, witnesses for the taxpayer had sworn that the outstanding information requested by HMRC was no longer available (or had otherwise never existed). In such circumstances, applying the balancing exercise as set out by the UT in *Frosh & Another v HMRC* [2017] UKUT 320 (TCC), the FTT concluded that there were no reasonable grounds to maintain the enquiry. If HMRC considered, in the absence of the further information that the relevant payments were not eligible for charity tax relief, they were entitled to issue a closure notice on that basis. In turn, the taxpayer would be entitled to appeal the closure notice and it would then be for the FTT to determine the outcome on the balance of available evidence. The FTT therefore directed HMRC to issue a closure notice within four weeks of its decision.

Comment

Many taxpayers may well recognise the "computer says no" approach apparently adopted by HMRC in this case when faced with assurances that information no longer existed. As noted above, the power to apply to the FTT for a closure notice is an important safeguard for taxpayers when faced with a protracted enquiry, which can clearly be both disruptive and expensive to manage. However, taxpayers should always be wary of exercising this power – a premature application, if not simply dismissed by the FTT, clearly carries the risk of bouncing HMRC into an unfavourable decision.

Other developments

HMRC announcements

Autumn Statement announcements on compliance

On 17 November 2022, Chancellor Jeremy Hunt used the Autumn Statement to announce that the programme to repair the country's public finances, as well as spending cuts and tax rises, would need to be supported by a package of measures to tackle tax avoidance, evasion and wider non-compliance, estimated to raise an additional £1.7 billion over the next five years. This includes, for example, investing a further £79 million in additional HMRC staff to help tackle serious tax fraud and tax compliance risks among wealthy taxpayers. The Government forecasts that this investment will raise £725 million in additional revenue over the next five years.

HMRC interest rates raised to highest level since 2008

HMRC are required by statute to charge interest where tax is not paid by the required date. The rate of interest charged fluctuates but typically tracks above lending bank rates. The recent interest rate increases announced by the Bank of England have therefore had a knock-on effect for interest rates charged by HMRC. From 14 November 2022, the interest rate on unpaid corporation tax quarterly instalments rose to 4% and the rate on overpaid instalments rose to 2.75%. For all other taxes and duties, the interest rate for late payments increased to 5.5% from 22 November 2022 (the eighth such increase in 2022 alone and the highest level since 2008). Interest will also be paid on repayments made by HMRC but at much lower rates.

Interest will continue to accrue until paid, even where it is agreed with HMRC that payment of a tax assessment may be postponed pending the outcome of litigation. The increased rates of interest charged by HMRC may be particularly controversial in circumstances where, for example, a taxpayer feels that HMRC have unreasonably delayed litigation proceedings.

Whilst there is no formal appeal procedure in respect of the amount of statutory interest charged, it is open to taxpayers to raise objections to statutory interest on certain limited grounds. Objections will normally be considered by HMRC's Interest Review Unit once any underlying tax has been paid (so that the amount of interest chargeable is known). Taxpayers who wish to raise an objection should seek professional advice as to whether this may be possible in their particular circumstances and also to discuss related strategy.

Government U-Turns on IR35 reform

One of the much-feted announcements in Kwasi Kwarteng's short-lived mini-budget (the Growth Plan 2022) was the reform of recent changes to the UK's off-payroll rules (often known as "IR35"). While some headlines appeared to suggest – wrongly - that IR35 was being abolished in totality, the planned reforms would have actually reversed certain changes to the regime introduced in 2017 and 2021. A return to the pre-2017 position would have meant that a personal service company, when engaged to provide a service by any third party in the public or private sector, would once again be responsible for determining its own worker's status for tax purposes and accounting for any tax liabilities.

As announced by the new Chancellor Jeremy Hunt on 17 October 2022, these reforms will no longer go ahead, meaning that the liability for determining worker status for tax purposes remains with the end-user. The effect is that public sector bodies and medium and large size businesses contracting with personal service companies must continue to carry out status determination assessments and will remain responsible for deducting PAYE and NICs as applicable.

Review of hybrid and distance working to be completed by end of 2022

It was announced earlier this year that the Office of Tax Simplification ("**OTS**") would be conducting a review on the emerging trends and tax implications of hybrid and distance working. This is planned to be a high-level evidential review of the current extent of hybrid and distance/home working, whether it is likely to increase, whether this trend involves more working across borders, and whether changes in working practices give rise to tax issues for employers, employees and businesses. For example, one of the main issues thrown up by new working practices in the aftermath of the pandemic is the extent to which a business might be treated as having a permanent

establishment in the jurisdiction from which their workers are now regularly operating (if different than before).

The OTS has invited responses to specified questions, as well as any general or specific comments on this issue. The original deadline for responses was 25 November 2022. However, this deadline was brought forward to 28 October 2022 in light of Kwasi Kwarteng's mini-budget (which announced the closure of the OTS, thereby necessitating the need for an accelerated timetable). The OTS is now scheduled to complete its review by the end of 2022. If you are a business or individual facing potential issues in this area, please contact a member of the team for advice.

HMRC crack down on R&D tax claims

HMRC's Fraud Investigation Service is reportedly issuing standard letters to some taxpayers in response to recent claims made for research and development ("**R&D**") tax relief. The letter includes the following statement:

"*We continuously monitor systems and customer records to guard against fraudulent activity. The claim triggered an alert on our systems and has caused HMRC to believe that you have fraudulently claimed money to which you are not entitled.*"

The letter asks taxpayers who think there has been a mistake to contact HMRC within 30 days in order for their claim to be re-examined but cautions that, although a criminal investigation into suspected fraud has not yet been opened, HMRC reserve the right to do so and anything the taxpayer may say could be used as evidence. If taxpayers decide not to contact HMRC, their claims will be cancelled. In other words, HMRC are offering taxpayers the choice between, on the one hand, having their (potentially valid) claims cancelled without further investigation or, on the other, pursuing claims but risking criminal investigation. The highly aggressive nature of these standard letters has been much criticised, forcing HMRC to publish a statement to deny that they had expressly accused recipients of fraud.

These letters represent the latest in a rise in activity from HMRC in this area, having also reportedly allocated extra staff to assist with a backlog of R&D tax claims following a huge surge in the number of such claims being made (including the number of fraudulent or otherwise speculative claims). Expected legislative changes for accounting periods beginning on or after 1 April 2023 will also see further changes intended to curb abuse, including that all claims are to be made digitally and endorsed by a senior officer of the claimant company (and pre-notified within six months of the end of the relevant accounting period).

Given these developments, any existing or future R&D tax claims, whether valid or not, are at increased risk of investigation (in some case, potentially criminal). Any taxpayers who receive a letter such as referred to above (or otherwise denying the claim or asking for further information), even if confident of their position, should seek appropriate legal advice as soon as possible. Not all investigations will start with a letter such as this – any taxpayers who are concerned about an existing claim or are otherwise unsure of their tax position should also seek advice and, where appropriate, make a voluntary disclosure of any errors.

Loan charge discovery assessments

The loan charge was introduced in the Finance (No. 2) Act 2017 as a one-off, retrospective tax charge on disguised remuneration loans made on or after 9 December 2010 where part or all of the loan was still outstanding on 5 April 2019. Very broadly, it was aimed at arrangements whereby individuals were paid for work or services in the form of a loan that was unlikely to ever be repaid, thereby designed to avoid amounts of income tax and NICs.

HMRC are now reportedly issuing discovery assessments to individuals who they believe should have declared the loan charge in their self-assessment tax return for the tax year 2018/19, and who either did not include the charge altogether or did not include it properly. The reason behind the timing is that the 2018/19 tax year will shortly fall outside the normal four-year time limit for discovery assessments. Recipients will normally have 30 days to appeal the assessment (and, if applicable, to postpone payment pending the appeal) and should therefore seek appropriate professional advice as soon as possible.

Civil evasion penalties not suitable for ADR

Where appropriate, taxpayers can apply for their tax dispute to be subject to ADR proceedings by way of formal mediation. The ADR process is non-statutory and entirely voluntary, meaning any application for, or entering into, ADR should not affect a taxpayer's statutory rights of appeal or review. Unlike commercial mediation, an HMRC employee will act as the mediator ("independent" in the sense that they will come from a specialist ADR team within HMRC and have had no prior involvement with the case). In some circumstances, and at the taxpayer's cost, it is also possible to appoint a third party to act as co-mediator. One key advantage of pursuing ADR is that, unlike most tax litigation cases, proceedings are entirely confidential.

Applications for ADR are considered by HMRC on a case-by-case basis, and they reserve the right to reject applications not considered appropriate. In particular, suitability will be determined by reference to the fact

that any settlement will need to comply with HMRC's Litigation and Settlement Strategy (which broadly means that the settlement must accord with HMRC's interpretation of relevant law and that HMRC cannot settle for less than they think they can get by litigating).

HMRC's published guidance includes a list of certain types of cases which will automatically be deemed unsuitable for ADR, including, for example, any case being handled by HMRC's criminal investigators. That list has recently been updated to confirm that ADR cannot be used in respect of disputes over civil evasion penalties, which can be sought by HMRC in certain cases of evasion instead of pursuing a criminal investigation. For example, section 25 of the Finance Act 2003 provides that a civil evasion penalty may be imposed where a person is engaged in any conduct for the purpose of evading import VAT or customs duty and that person's conduct involves dishonesty.

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 aim being that the taxpayer will likely accept those figures by default). Over the last few months, HMRC have launched several new nudge letter campaigns on various issues, as summarised below.

Rollover relief on residential letting sales (August 2022)

HMRC are sending letters to taxpayers who made a Business Asset Rollover Relief claim in relation to a disposal of residential property in their self-assessment tax return for the tax year 2020/21. The letter reminds taxpayers that Business Asset Rollover Relief is not available for any gain arising from the disposal of a residential property in a letting portfolio (given that the letting of a residential property is not considered to be a trade). Taxpayers are requested to review and, if necessary, amend their self-assessment tax return by 30 days from the date of the letter, or risk HMRC opening an enquiry. Additionally, in November 2022, HMRC began sending similar letters for disposals in tax years prior to 2020/21.

Capital gains on share sales (August 2022)

Letters are being issued to those who ceased being "persons with significant control" in relation to companies registered with Companies House in the tax year 2020/21, and who have not included disposals of any shares in their self-assessment tax return for that period. The letter reminds the recipient that they may have to pay capital gains tax on any gains from a share disposal and instructs the taxpayer to amend their self-assessment tax return by 1 January 2023 should they subsequently ascertain that tax is payable.

Capital gains on second homes (September 2022)

HMRC are sending letters to taxpayers who either have recently sold or are currently marketing a residential property which was (or is) not their main residence (and to which principal private residence relief will not apply). The letter reminds taxpayers that the time limit for reporting and paying capital gains tax on the disposal of UK residential property on the UK Property Disposal Service is 60 days from the date of completion.

Individuals filing as non-resident due to exceptional circumstances (October 2022)

HMRC are sending letters to individuals who have filed as non-resident for the tax year 2020/21 and have included days attributed to exceptional circumstances or coronavirus-related work in their self-assessment tax returns. According to the issued letters, HMRC have seen a number of returns which attribute more days to either exceptional circumstances or coronavirus-related work than permitted by the relevant legislation (60 days and 57 days, respectively). The letters therefore urge recipients to check that they have not exceeded such limits and to make sure that the necessary requirements have been satisfied. If any amendments are necessary, taxpayers are asked to amend their return by 1 January 2023.

Individuals who have claimed foreign tax credit relief (October 2022)

HMRC are sending nudge letters to individuals who claimed foreign tax credit relief for foreign tax paid on employment income in their self-assessment tax return for the tax year 2020/21. The letter sets out the principles that taxpayers must be aware of should they submit a similar claim for the tax year 2021/22.

ATED revaluation date (October 2022)

Letters are being issued by HMRC to taxpayers who pay ATED in relation to properties within scope of the charge. The letter reminds taxpayers that the latest revaluation date is 1 April 2022, and this valuation must be used in the ATED return for the period from 1 April 2023 to 31 March 2024.

Persons with significant control with suspected under-declared income (October 2022)

HMRC have issued letters to those registered at Companies House as being "persons with significant control" but (i) whose income for the tax year 2020/21 was less than £100,000 or (ii) who did not file a self-assessment tax return for that year. Recipients of the first letter are advised to check whether their return reflects all sources of income and gains, and to amend it by 31 January 2023 if they realise it does not do so. Recipients of the second letter are advised to check whether they need to file a self-assessment tax return for the tax year 2020/21 and reminded that, if they do, they may be liable for a penalty given the deadline of 31 January 2022 has passed (unless they can demonstrate a 'reasonable excuse' for failure to do so).

Non-compliance linked to offshore corporates owning UK property (November 2022)

HMRC announced that they would be commencing a nudge letter campaign aimed at tackling non-compliance linked to offshore corporates owning UK property. Two example letters have been published as part of this campaign:

— one to non-resident companies owning UK property who may need to disclose either income received as a non-resident corporate landlord, or an ATED liability. Recipients are also directed to tell any UK resident individuals who have an interest in the income or capital of the company to check whether their tax affairs are up to date with the transfer of assets abroad legislation; and

— one to non-resident companies who appear to have made a disposal of UK residential property between 6 April 2015 and 5 April 2019 without filing an NRCGT return.

Each letter is to be accompanied by a certificate of tax position and a notice of intention to disclose.

Individuals earning money driving for online applications (November 2022)

Letters are being issued to individuals who have earned money driving customers who booked using online applications (for example, companies such as Uber and Lyft). The letter states that HMRC have information showing that the individual has under-declared income earned in this way, and is accompanied by a certificate of tax position which the recipient is directed to complete and return.

Landlords who have submitted deposits into the Tenancy Deposit Scheme (November 2022)

HMRC are sending letters to landlords who have submitted deposits into the Tenancy Deposit Scheme, but who they believe have under-declared rental income in the 2020 to 2021 tax year. Taxpayers are directed to check their self-assessment tax returns for the 2020/21 tax year and make amendments within 30 days of receipt of the letter. Recipients are also asked to ensure that they have declared all rental income on their return for the tax year 2021/22 and that, if they have sold or otherwise disposed of a rental property recently, they may be liable to pay capital gains tax on any profit made.

Taxpayers who have claimed EIS deferral relief (November 2022)

Letters are being sent to individuals who claimed deferral relief under the Enterprise Investment Scheme. The letter reminds taxpayers that, in certain circumstances, such a deferred gain can be "*revived*", and therefore chargeable; the letter sets out the five scenarios in which such a revival may take place. Recipients are requested to consider whether any of those scenarios have occurred and, if necessary, to correct previous returns.

Share disposals by persons with significant control (November 2022)

HMRC are issuing letters to those who, according to Companies House, ceased to be a "person with significant control" in the tax year 2021/22 and who may, therefore, have disposed of shares. The letters remind the recipient that disposals of shares can give rise to capital gains tax and to therefore check whether gains should have been declared on their self-assessment tax returns.

Inconsistencies in corporation tax losses (November 2022)

HMRC are sending nudge letters where they have identified inconsistencies relating to Company Tax Return (CT600) filings, where the amounts submitted in that form do not reconcile with those in the corresponding corporation tax computations provided. In particular, HMRC have noticed that some boxes on the CT600 include brought-forward losses which are now disallowed under the changes to the loss relief rules in 2017. HMRC will rely on the tax computations as the accurate position for the companies' losses and will be writing to affected companies and their representative agents to make them aware of the situation.

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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