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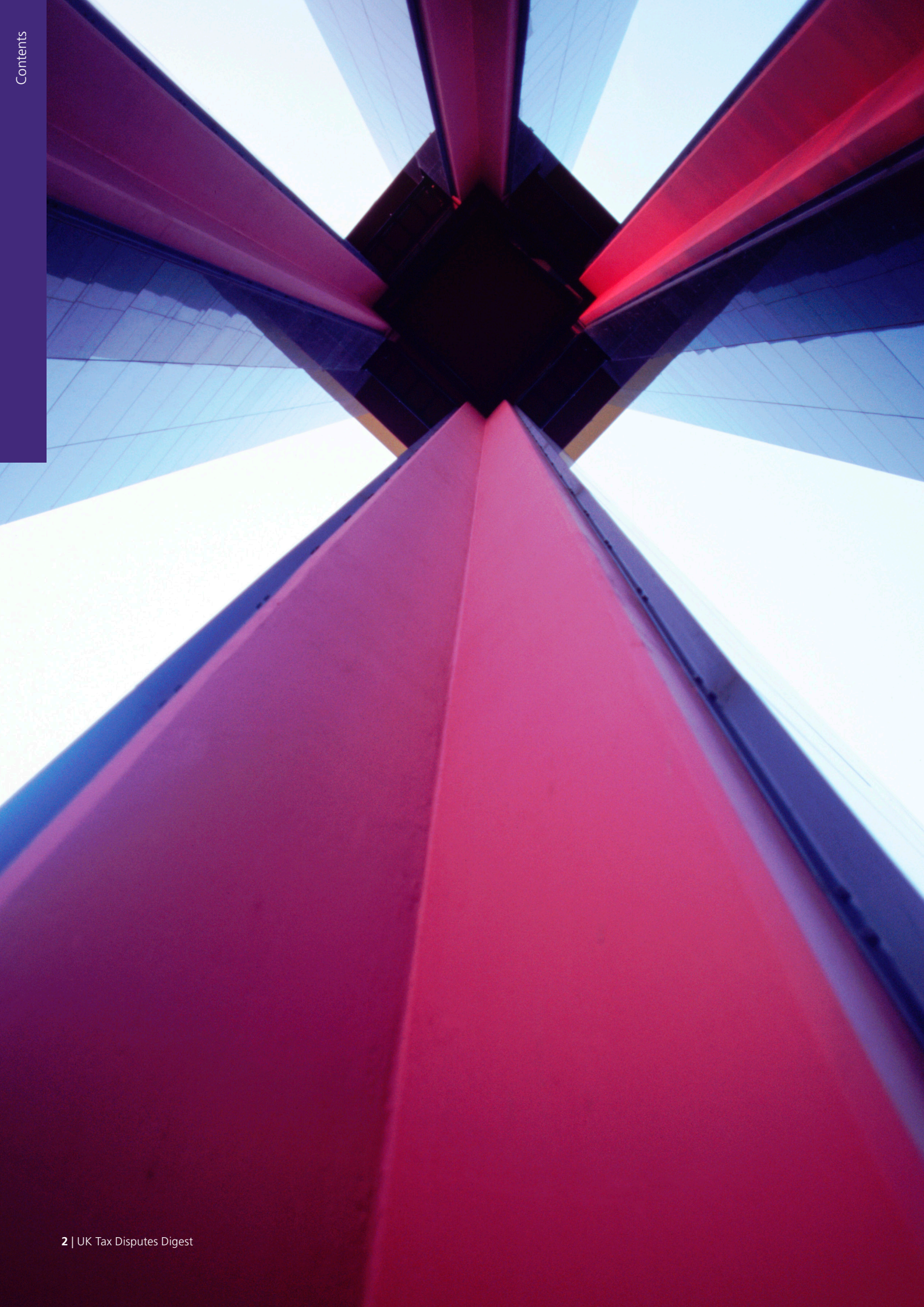
UK Tax Disputes Digest

Autumn 2023



Contents

Introduction

Welcome to the autumn 2023 edition of our UK Tax Disputes Digest: a high-level summary of key developments in contentious tax over the last few months for heads of tax, finance directors, general counsel and other in-house professionals.

We have seen a continued increase in HMRC activity across various areas. In this edition, we look at just a few of the latest developments, including a report into historic non-compliance around research and development ("**R&D**") tax reliefs, the creation of a new HMRC Pillar 2 compliance team and the latest statistics from HMRC's published reports. We also cover a number of notable tax cases, including a focus on recent case law developments relating to the interpretation of main purpose tests in UK anti-avoidance legislation.

As part of our commitment to provide clients with relevant updates and resources, the CMS tax group has also launched a new comprehensive online guide to the taxation of crypto-assets. Please see here for further information.

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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In focus: "Main purpose or one of the main purposes"– recent case law developments

The phrase "main purpose or one of the main purposes" (of obtaining a tax advantage) is a key feature of UK tax legislation, particularly in the context of targeted anti-avoidance provisions. Given its importance, it is perhaps not surprising that the main purpose test is currently the subject of frequent judicial scrutiny. In practice, the issue is often whether a taxpayer might be said to have a main purpose of obtaining a tax advantage, where tax planning has been undertaken in the wider context of a commercially-driven transaction. Whilst some consistency of approach would provide clarity as regards the scope of the application of these rules, it may be argued that the opposite is happening: a divergence of views as to how to apply main purpose tests in the various contexts in which they arise. In overview, the issue may be summarised as one of whether to take a "big picture" view, giving significant weight to the commercial drivers in the wider commercial context. From this "big picture" perspective, the tax planning objectives may well not be regarded as a main purpose. The alternative approach is more detail-orientated, placing greater emphasis on the tax planning objectives, notwithstanding the wider commercial backdrop.

Background

There are a number of main purpose tests in UK tax legislation. Examples include: the transactions in securities legislation (section 684(1)(c) of the Income Tax Act 2007); the rules on transfers of intangible assets (section 831 of the Corporation Tax Act 2009, "**CTA 2009**"); and anti-avoidance provisions within the capital allowances code (section 123(4) of the Capital Allowances Act 2001).

Two of the most commonly-encountered areas where main purpose tests arise, and those which are of relevance to the recent case law developments, are as follows:

— firstly, in the context of capital gains tax and corporation tax on chargeable gains (referred to as "**CGT**" for simplicity), the "rollover" provisions of section 135 of the Taxation of Chargeable Gains Act 1992 ("**TCGA**") are switched off if the transaction forms part of a scheme or arrangements of which the main purpose, or one of the main purposes, is the avoidance of tax (section 137 TCGA); and

— secondly, the unallowable purpose rule (section 441 CTA 2009) provides that a company must not bring into account so much of a loan relationship debit as is attributable to an unallowable purpose. A company has an unallowable purpose if at times during a relevant accounting period, the company is party to a loan relationship for purposes which include a purpose which is not amongst the company's business or other commercial purposes. This would include circumstances where the company is party to a loan relationship with a tax avoidance purpose, unless that purpose is not the main purpose or one of the main purposes for which the company is party to a loan relationship.

There is now a significant body of case law on how to interpret main purpose tests in UK anti-avoidance legislation. A full review of relevant case law is beyond the scope of this article; instead, we intend to draw out some themes arising from two recent authorities, with brief reference also to a case which is (at the time of writing) shortly expected to be heard by the Court of Appeal.

CGT planning

In *Wilkinson v HMRC* [2023] UKFTT 00695 (TC), the First-Tier Tribunal ("**FTT**") recently considered whether an exchange of shares in one company for loan notes and shares in another company formed part of a scheme or arrangement of which the main purpose, or one of the main purposes, was avoidance of liability to CGT (for the purposes of section 137 TCGA). The facts of that case relate to the sale of a logistics business by a number of individuals, including a Mr and Mrs Wilkinson. The tax planning involved making use of the aggregate entrepreneurs' relief lifetime limit of the couple's three daughters, to whom some of their shares were transferred in advance of the transaction. Upon completion of the transaction, the daughters received loan notes to be redeemed after the minimum holding period for entrepreneurs' relief had expired.

The case of *Euromoney Institutional Investor v HMRC* [2021] UKFTT 61, involving broadly similar CGT issues in relation to a share exchange in the context of a commercial transaction, is expected to appear before the Court of Appeal during October 2023. In this case, cash consideration (which would not, in the particular circumstances, have benefited from the substantial shareholding exemption from CGT) was replaced by redeemable preference shares, to be redeemed once the holding period for the substantial shareholding exemption had been reached.

In both of these cases, the issue at stake was essentially whether achieving the intended tax saving was a "main purpose".

The decisions in these CGT cases have, to date, taken a "big picture" view of what is a main purpose, with the result that HMRC did not succeed in defeating the CGT planning that had been undertaken. The fact that the broader context was that of a genuine disposal to a third party, where the tax planning was a small element of the overall picture, certainly seems to have been an influential feature of the "big picture". It will be interesting to see what the Court of Appeal judgment in *Euromoney* eventually adds to our understanding of the main purpose text in this context.

Unallowable purpose

However, recent case law relating to the unallowable purpose rule in relation to loan relationships (section 442 CTA 2009), including the decision of the Upper Tribunal ("**UT**") in *JTI Acquisitions Company (2011) Limited v HMRC*, has concluded that borrowing entered into to fund a commercial acquisition may fall foul of the relevant main purpose test, in circumstances where it may have been hoped that the broader commercial context (of funding for a commercial acquisition) would provide some protection from the application of the test.

In this case, the taxpayer was a UK newco formed to make the acquisition of a US-headed equipment group, funded by intra-group borrowing upon which arm's length interest was paid. Essentially, the intended result was that a UK tax deduction arose in relation to the acquisition of a US corporation, with no corresponding taxable receipt in the US.

Finding in favour of HMRC, the UT emphasised that in determining whether an unallowable purpose exists, a "wide-ranging and fact-sensitive enquiry of all the circumstances is called for" and that there is nothing to preclude the application of the unallowable purpose rule to a purchase of commercial assets with arm's length borrowing.

In the loan relationship context, it would therefore appear that this, and other recent decisions, are tending towards a decidedly detail-orientated approach to determining main purpose.

Comment

Do recent case law developments suggest that the "big picture" approach to the main purpose tests has more relevance in some contexts than others? It would certainly seem that CGT planning is at less risk of challenge where it takes place in the context of a commercial disposal, yet acquisition debt entered into in order to fund an acquisition of shares or assets from a third party is not protected from challenge on the grounds of unallowable purpose. Perhaps there is no single approach to determining main purpose, but instead a series of separate, context-specific, main purpose tests, each of which should be read entirely differently? This would seem set to add an additional area of uncertainty, to (already complex) anti-avoidance legislation. Taxpayers should, of course, seek appropriate professional advice to help navigate these complex issues.

Other notable tax cases

R (Realreed Ltd) v HMRC [2023] EWHC 1572

The High Court considered a judicial review brought by the taxpayer in part on the basis of legitimate expectation. The taxpayer was the owner of a large block of flats, some of which were leased as serviced accommodation. The taxpayer treated these as exempt supplies for VAT purposes, but this was later challenged by HMRC on the grounds that these should have been treated as taxable supplies. The taxpayer made an appeal to the FTT against HMRC's assessments, but also brought separate proceedings by way of judicial review. The main ground for judicial review was that, even if the supplies were taxable, the fact that prior HMRC investigations had failed to raise the issue had given rise to a legitimate expectation. The High Court dismissed the taxpayer's claim, deciding that there was no evidence that HMRC had carried out a critical examination of the relevant issue and, perhaps more importantly, had not told the taxpayer that they had done so and so there could be no detrimental reliance. It is interesting to note that the relevant HMRC officers had repeatedly referred to the relevant supplies as being exempt, even carrying out partial exemption calculations premised on that assumption, so this was not a case where HMRC were simply silent as to the tax treatment.

R (Vision HR Solutions Ltd) v HMRC; R (Veqta Ltd) v HMRC [2023] EWHC 1659

The High Court refused an application for judicial review from two claimant companies over the publication of information under section 86 of the Finance Act 2022 ("**FA 2022**"). This provision provides HMRC with the power to publicise information about suspected tax avoidance schemes, which HMRC had used to include the two claimant companies on their published list of promoters of tax avoidance. The claimants sought judicial review on a number of grounds, including that section 86 was incompatible with retained EU law, alongside alleged breaches of the ECHR (including that listing under section 86 FA 2022 constituted the bringing of a criminal charge for the purpose of Article 6). The High Court dismissed the application on all grounds, holding that, since section 86 FA 2022 is a piece of primary legislation enacted after Brexit Implementation Day, it cannot be declared invalid or disapplied by reason of incompatibility with EU law. The High Court also noted the public interest of taxpayers being warned about such schemes, so that taxpayers can make informed decisions about whether to participate in them. Finally, the High Court affirmed the principle that parties have a duty of candour when

bringing a judicial review, and the failure of the claimants to comply with this (apparently not being entirely forthcoming in their answers to questions put by the Court) added a further reason as to why the claimants should not be permitted to pursue the claim.

HMRC v A Taxpayer [2023] UKUT 182 (TCC)

The UT has overturned the decision of the FTT in the first case on the UK's statutory residence test, which was introduced by the Finance Act 2013. A key element of the test is the number of days an individual may spend in the UK in the relevant tax year. Days will not count towards the relevant threshold where they are days on which a taxpayer has been prevented from leaving the UK due to "exceptional circumstances" beyond the taxpayer's control. The UT found that the FTT had erred in law in finding that the taxpayer's "moral obligation" towards her sister's children (whose care had been impacted by her sister's alcoholism and depression) was an "exceptional circumstance" for the purposes of the relevant provision, and additionally that the FTT had failed to consider whether that obligation "prevented" the taxpayer from leaving the UK – an essential element of the exemption. Given that this is the first case on the statutory residence test, the UT decided to provide guidance in the form of a list of factors to be considered where the "exceptional circumstances" provision comes before the FTT in the future.

Blue Lagoon Beach Hotel & Co Ltd [2023] UKPC 24

The Judicial Committee of the Privy Council ("**JCPC**") held that the taxpayer, a hotel operator in Mauritius, was required to account for Mauritian VAT on fees for rooms that were paid in advance by tour operators (in full and on a non-refundable basis), even though some of those rooms eventually went unoccupied. The taxpayer had treated the income from the unoccupied rooms as "special income", arguing that it was not consideration for a chargeable supply of services and consequently was not subject to VAT. The JCPC disagreed, deciding that VAT had to be accounted for on the full amount of the fees, irrespective of whether the rooms had been occupied or not, citing UK and EU case law decisions such as *Customs and Excise Commissioners v Bass plc* [1993] STC 42. The JCPC distinguished a leading decision regarding deposits, *Société thermale d'Eugénie-les-Bains v Ministère de l' Économie, des Finances et de l'Industrie* (C-277/05), as here the tour operators were paying a full fee for the room and not a deposit. Moreover, the tripartite nature of the relationship (i.e., including hotel guests) did not affect the services offered, which was from the hotel operator to the tour operators. Although this case was relating to the Mauritian VAT code, it was common ground that this should be construed in accordance with the equivalent UK legislation. Furthermore, the JCPC (as the final court of appeal for UK Crown dependencies, UK overseas territories and many Commonwealth countries) shares the same judges as the UK Supreme Court. The decision is still therefore important for UK taxpayers and practitioners.

William Archer v HMRC [2023] EWCA Civ 626

This Court of Appeal decision concerned an appeal against surcharge notices, specifically whether the taxpayer had a reasonable excuse for failure to pay tax. HMRC had issued closure notices which the taxpayer's accountants argued were not validly made (because they did not expressly state any amount of tax due). The accountants therefore failed to make a statutory appeal to the FTT within the required time limit and HMRC threatened to commence bankruptcy proceedings. The taxpayer then started a judicial review claim against the decision to commence bankruptcy proceedings, which was refused by the High Court and, on appeal, by the Court of Appeal. Permission to appeal to the Supreme Court was subsequently also refused.

HMRC had also issued surcharge notices to the taxpayer for failure to pay the tax, which the taxpayer appealed on the basis that he had a reasonable excuse for non-payment (as he considered no tax was due) and which the parties agreed to stand over pending the outcome of the judicial review proceedings. Following the failure of the judicial review, this appeal became live again. The taxpayer's appeal against the surcharge notices was dismissed by the FTT and the UT. On further appeal, the Court of Appeal held that the judicial review had initially provided a reasonable excuse for non-payment, particularly as paying the amounts due prior to determination of the judicial review proceedings could have been detrimental to the taxpayer's case. However, the non-payment ceased to be reasonable after the adverse verdict of the High Court (notwithstanding the continued appeal before the Court of Appeal and the application for permission to apply to the Supreme Court). The Court of Appeal did, however, determine that the UT had erred in holding that the taxpayer was required to give evidence of his subjective belief as to the strength of his judicial review.

R (on the application of Glint Pay Services Ltd) v HMRC [2023] EWHC 1621 (Admin)

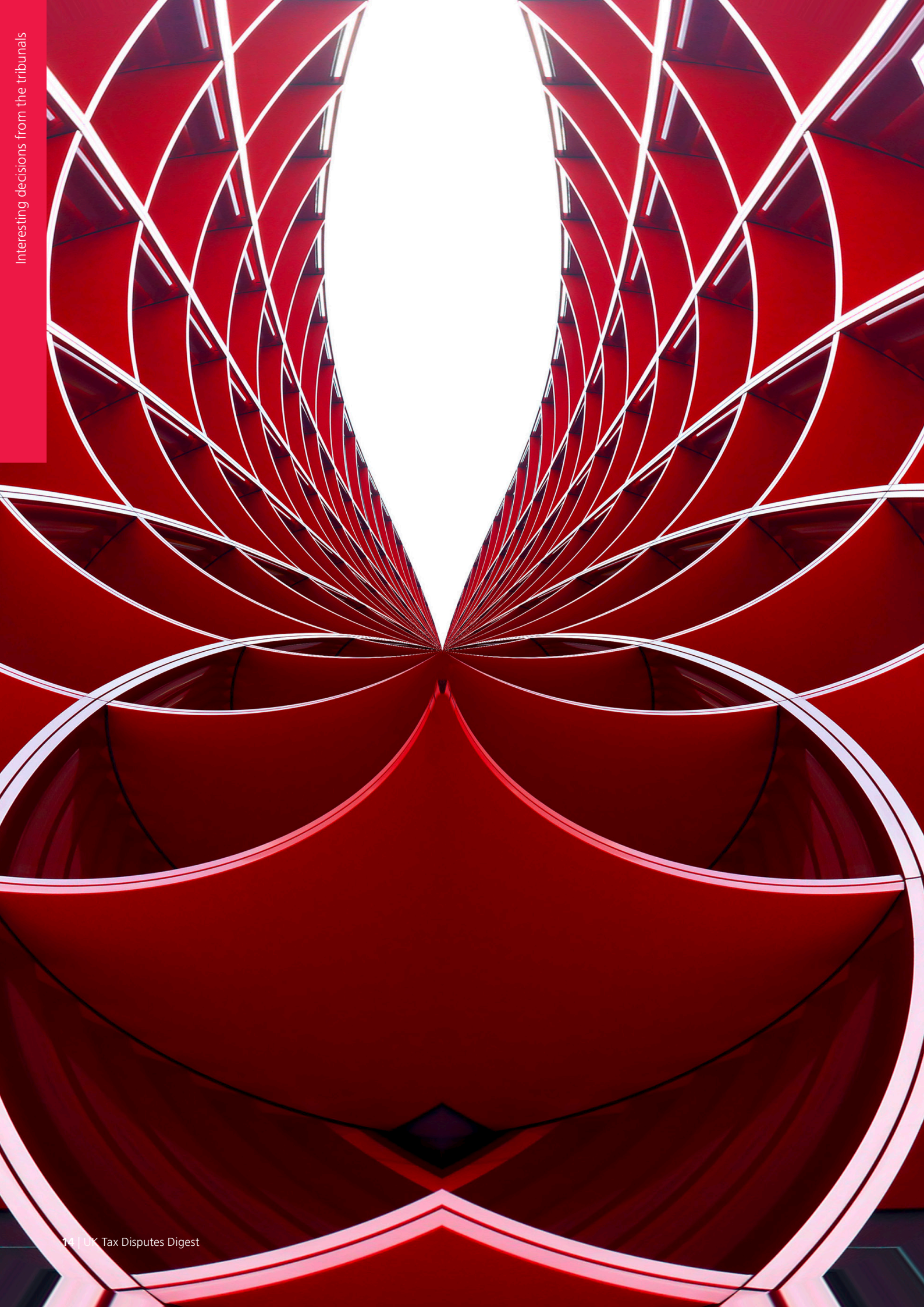
In this case, the High Court dismissed a taxpayer's judicial review challenge of a decision by HMRC that its supplies of gold were to be treated as exempt from VAT, rather than zero-rated (therefore impacting its ability to recover associated input tax). The taxpayer claimed that a memorandum of understanding to which HMRC was a party gave it a legitimate expectation of a zero-rating, frustration of which was an abuse of power and that, in light of this, HMRC's decision was irrational. The High Court held that there was no representation made by HMRC to the taxpayer that was clear, unambiguous, and devoid of qualification that its supplies of gold would be zero-rated. The High Court also opined that, regardless, it would not be deemed unfair or an abuse of power to frustrate any expectation of zero-rating the taxpayer might have had, as there was no justification to override the public interest in HMRC's collection of VAT in accordance with the clear provisions of the law. This was particularly the case here as neither the taxpayer nor its advisers had ever sought clarification from HMRC regarding the applicability of the memorandum to the taxpayer's business model. This decision is an important reminder to taxpayers that there are strict conditions that must be satisfied in order for them to acquire a legitimate expectation.

R (PACCAR Inc and others) v Competition Appeal Tribunal and others [2023] UKSC 28

While not relating to a "tax" case, this Supreme Court decision will have significant ramifications for litigation funding in all areas of disputes. In this decision, the court held that litigation funding agreements ("**LFAs**"), pursuant to which the funder is entitled to recover a percentage of any damages recovered by the litigant, constitute "damages-based agreements" ("**DBAs**"). In brief, this is because the majority of the bench found that "claims management services" – the relevant limb of the definition of a DBA in this case – should be interpreted as including the provision of litigation funding. The consequence of the decision is that any current or future LFAs must meet the strict statutory requirements for DBAs, if they are to remain wholly enforceable. The decision is of critical importance to parties that rely (or plan to rely) on litigation funding and litigation funders, who will be hoping that Parliament introduces legislation to remedy an arguably unintended consequence of the statutory definition of a DBA.

Intelligent Money Ltd v HMRC [2023] UKUT 236

The UT considered whether fees paid to the administrator of a self-invested personal pension ("**SIPP**") should be treated as consideration for a supply of insurance for VAT purposes and therefore exempt from VAT. Based on recent decisions of the Court of Justice of the European Union ("**CJEU**"), the UT held that, for the purposes of the insurance exemption from VAT, insurance should broadly involve the insurer bearing the cost of the insured risk. The UT drew a distinction between, on the one hand, cases where the premiums become owned by the insurance company and the cost of the payment benefits is made out of the insurance company's own resources (even if the amount payable is notionally determined by reference to the value of underlying investments) and, on the other hand, a case in which the premiums remain substantially owned by the insured person and the benefits are paid out of funds held substantially for the benefit of the insured person and/or other beneficiaries. It was held that the SIPP arrangement in this case, where the cost of the life and death benefits provided to the member was borne by a member's own fund, fell within the latter category and therefore outside the scope of the exemption. The UT acknowledged that its conclusions potentially mean that the insurance exemption can extend to some life insurance contracts with an investment element.



Interesting decisions from the tribunals

VAT recovery from professional services in share sales

In *HMRC v Hotel La Tour Ltd* [2023] UKUT 00178 (TCC), the UT considered whether VAT could be recovered from fees incurred for professional services rendered in connection with the sale of shares.

Background

Hotel La Tour Ltd ("**HLT**") was the holding company of Hotel La Tour Birmingham Limited ("**HLTB**"), which in turn owned and operated a luxury hotel in Birmingham. HLT and HLTB were members of a VAT group of which HLT was the representative member. In 2015, HLT decided to construct a new hotel in Milton Keynes, which was anticipated to cost £34.5 million. To finance the construction, HLT sold their shareholding in HLBT and obtained the shortfall via a bank loan.

In the course of selling HLBT, HLT incurred fees in respect of professional services in the amount of £382,899.51 plus VAT of £76,822.95. HLT sought recovery of that input VAT in one of its 2017 quarterly VAT returns. The input VAT recovery was subsequently challenged by HMRC on the basis that the professional services which gave rise to the fees were used in making an exempt supply by way of the sale of shares in HLBT (rather than for making taxable supplies).

Considering a line of UK and CJEU jurisprudence, the FTT had agreed with HLT that the claimed input VAT should be recoverable for the following reasons:

1. in fundraising cases, the relevant objective purpose is of the fund-raising and the relevant use is the use of the funds (citing *Frank A Smart & Son Ltd v HMRC* [2019] UKSC 39);
2. the rider to point (1) above is that the chain will be broken where the cost of the inputs was a cost component of the price of the shares in the initial transaction. The FTT found that the fees were not incorporated into the price of the shares sold;
3. HLT had a downstream taxable business of the building, development and ultimately management of a new hotel business;
4. HLT's financial position was such that it could not afford to develop the new hotel business without entering into the share purchase agreement for the sale of HLBT and this was documented under the terms of the agreement;
5. the objective purpose of incurring the costs of the services was to raise the funds to pay for the "downstream transactions" (i.e., development of the new hotel business); and
6. therefore, there was a "direct and immediate link" between the fees incurred for the professional services and a taxable downstream economic activity.

Decision

Before the UT, heavy reliance was placed by HMRC on the CJEU case of *BLP Group plc v HMRC*. The background facts in BLP were fairly similar, where a taxpayer had sold shares in a company in order to raise funds for the purpose of paying off debts incurred while making taxable transactions. The CJEU held in that case that the taxpayer was not entitled to recovery on the basis that the services were used for a VAT-exempt activity.

HMRC argued that a two-stage approach should be applied as follows:

1. ask whether there was an output transaction on transactions to which the inputs were directly and immediately linked; and
2. only if there was no direct and immediate link to an output transaction in the scope of VAT was it necessary to consider whether there was a direct and immediate link to a general economic activity.

Citing *BLP*, HMRC submitted that the FTT had erred in its decision by applying stage two above to consider input VAT incurred on fees against the wider economic activities of HLT, notwithstanding the fact that a direct link could be established between the fees and VAT-exempt activity at stage one.

The UT rejected these submissions and affirmed the FTT's decision, going so far as to endorse the FTT's application of the legal principles to the facts of this case as "unimpeachable". CJEU jurisprudence had evolved considerably in this area of VAT law and required a more holistic approach towards the consideration of the taxpayer's wider economic activities. This approach was recognised by the UK courts (see *TLLC Limited* [2013] UKFTT 467 (TC), *Associated Newspapers Ltd v HMRC* [2017] STC 843 and *Frank A Smart*).

Comment

The decision of the FTT (now confirmed by the UT) may well have come as a surprise to many tax practitioners. Albeit the test is fact sensitive and a matter of impression based on all the circumstances, this signals an opportunity for taxpayers to rely on first principles to consider as part of their VAT recovery strategy whether any costs incurred for traditionally VAT-exempt activities are "directly and immediately linked" to downstream taxable economic activities. It is understood that HMRC has sought permission to appeal this decision. In the meantime, businesses should note that claims for input VAT recovery are generally limited to four years from when the entitlement to make the claim to deduct arose.

Interestingly, the principle of fiscal neutrality featured strongly in recent CJEU jurisprudence on the attribution of input VAT to downstream outputs. Plainly, fiscal neutrality is a fundamental principle of the common system of VAT which precludes treating similar supplies of services differently for VAT purposes.

UT denies application of the SSE to a "group of one"

In *M Group Holdings Ltd v HMRC* [2023] UKUT 00213 (TCC), the UT agreed with the FTT that the substantial shareholding exemption ("**SSE**") did not apply to the chargeable gain from the sale of a newly-formed subsidiary that received the trade and assets of its parent company prior to its sale.

Background

Where the relevant statutory conditions are satisfied, the SSE exempts certain chargeable gains that would otherwise be subject to corporation tax on a disposal of shares. The relevant provisions are principally contained in schedule 7AC TCGA. Statutory references below are to schedule 7AC TCGA unless otherwise specified.

A key requirement for the SSE to apply on a disposal is that the investing company (i.e., the seller) must have held a "substantial shareholding" in the investee company (i.e., the target) throughout a 12-month period beginning not more than two years before the day on which the disposal takes place (paragraph 7).

However, paragraph 15A extends the period during which the seller is treated as holding the shares in the target in certain circumstances set out in paragraph 15A(2), as follows (emphasis added):

(2) *The conditions are —*

(a) *that, immediately before the disposal, the investing company holds a substantial shareholding in the company invested in,*

(b) *that an asset which, at the time of the disposal, is being used for the purposes of a trade carried on by the company invested in was transferred to it by the investing company or another company,*

(c) *that, at the time of the transfer of the asset, the company invested in, the investing company and, if different, the company which transferred the asset were all members of the same group, and*

(d) *that the asset was previously used by a member* ***of the group*** *(other than the company invested in) for the purposes of a trade carried on by that member* ***at a time when it was such a member****.*

If these conditions are met, the seller will be treated as having held the substantial shareholding at any time during the 12 months prior to disposal when – crucially for the taxpayer – the asset was used by another member of the group for its trade (paragraph 15(3)).

In this case, the taxpayer was a private company that provided services under NHS contracts as a stand-alone company until June 2015. With the sole shareholder of the taxpayer receiving interest from potential buyers, consideration was given to structuring a potential sale in a tax efficient manner. As now a fairly routine procedure for sales of trading companies, on 29 June 2015, a new subsidiary was incorporated, with the assets of the taxpayer being hived down to it on 30 September 2015. On 27 May 2016 (just shy of 11 months from the date the new subsidiary was incorporated), the taxpayer company sold the entire issued share capital of its subsidiary to a third party, and subsequently claimed the SSE to exempt the resulting chargeable gain from corporation tax.

HMRC disallowed the SSE on the basis that the conditions for the paragraph 15A "extension" were not met, with the result that a corporation tax liability of over £10 million was imposed on the taxpayer.

On appeal, the FTT agreed with HMRC that paragraph 15A(3) only extends the period of ownership for the purposes of paragraph 7 during such time as the relevant assets were held and used for the purposes of a trade by another company (in this case, the taxpayer) while it is a member of the same group. Here, as the taxpayer was only a member of a group from 29 June 2015 (i.e., the date that the target was incorporated), paragraph 15A did not extend the deemed period of ownership of the target shares to before that date. The taxpayer, on the other hand, had argued that paragraph 15A(3) should be construed as only requiring the assets to have been used by a member of the group during the 12-month period, not that there is a group in existence for the whole 12-month period.

Decision

On appeal to the UT, counsel for the taxpayer attempted to develop a new argument that the singleton company was in fact a "group", i.e., a "group of one". The UT held that there was "no merit at all" in this ground of appeal.

The taxpayer also argued that the provisions of paragraph 15A should be read differently to avoid absurdity and injustice, and that additional words should be read into the statute so as to apply to trading assets to be used by a group member "or the investing company" during the relevant period. In particular, it was pointed out that, if HMRC's view of the provision were correct, then a trading company with (perhaps by chance) a historically incorporated single dormant subsidiary would be able to benefit from the paragraph 15A extension - whereas a singleton company, which had not undertaken pre-sale planning in time, could not.

The UT broadly agreed with the FTT's interpretation of paragraph 15A, and disallowed the taxpayer's appeal. The UT applied the "ordinary meaning context and purpose" of the statutory provisions and held that, while it might produce an anomalous result (as compared with a seller which happened to have a long-standing dormant subsidiary), the result was not absurd and no injustice arose. It was apparent that Parliament had intended the paragraph 15A extension to apply to corporate groups, and not standalone companies. Additionally, they rejected the taxpayer's calls to read words into the statute, noting the "very high" bar for doing so had not been met.

Comment

As accepted by the FTT in its original decision, the outcome of the decision may have appeared somewhat odd and arbitrary (broadly for the reasons put forward by the UT). However, there was unfortunately no basis to support the taxpayer's rather "strained" interpretation.

The UT's judgment does, therefore, seem to provide a tacit endorsement of advance planning whereby a subsidiary of a standalone company is incorporated before any sale is anticipated, and remains dormant until assets are hived down shortly prior to sale. Taxpayers would be well-advised to consider whether setting up such structures now for any current or anticipated trading companies would prevent similar issues to those faced by the taxpayer in this case.

The latest development in the evolution of the unallowable purpose rule

The UT's decision in *JTI Acquisition Company Limited v HMRC* [2023] UKUT 00194 (TC) provides the latest instalment in the ongoing evolution of the unallowable purpose rule (sections 441-442 Corporation Tax Act 2009). Where this rule applies, the effect is to deny loan relationship debits where the taxpayer had a main purpose, in being party to the loan relationship, of obtaining a tax advantage.

Background

The debt in this case had been incurred by a UK newco formed to make the acquisition of a US target by a US headquartered group. The debt had initially been advanced by the US parent, but was subsequently assigned to a Cayman finance company. The debt was listed in order to qualify as a quoted Eurobond, with the result that no UK withholding tax arose in relation to payments of interest. The relevant entities were disregarded for US tax purposes, so that there was no income recognition as regards the interest received.

The intention had been to create an interest deduction in the UK, with no UK withholding tax and no income inclusion for the recipient of the interest.

The taxpayer's appeal from the decision of the FTT focused on a number of key issues. First, it argued that the FTT had failed to apply the legislation to the issue of the loan notes by the taxpayer itself, instead seeking to ascertain the purposes of the whole group in entering into the wider series of transactions. Further, it argued that the FTT had misapplied the concept of a "tax advantage", failing to focus on any UK tax advantage to the exclusion of any US tax advantage. It also argued that the FTT had misunderstood the scope of the rules and the intended approach to determining whether a tax advantage was a main purpose. Importantly, the taxpayer had argued that the existence of the taxpayer entity and the existence of the debt should be regarded as "givens".

Decision

The UT rejected the taxpayer's grounds of appeal. A central tenet of its approach was the Tribunal's view that the unallowable purpose legislation is deliberately drafted in expansive terms, to prevent tax avoidance, and that it would defeat Parliament's intention if an over-compartmentalised and narrow interpretation, such as that argued for by the taxpayer, were applied.

The UT's decision is consistent with principles established in prior cases, but may be useful as a recap of the principles in this developing area of law. In particular, the UT confirmed that it is necessary to look at all the facts and circumstances in determining the main purpose for which a company is party to the loan relationship, and that an examination of the wider context may include consideration of directing minds outside of the company. Importantly in the context of acquisition financing, it was confirmed that there is no rule that the unallowable purpose provisions are inapplicable to arm's length finance costs for a commercial acquisition.

Comment

It is, in a sense, reassuring to see the UT's decision being reached on a basis that is consistent with other recent case law and also with HMRC's recently issued guidance. It seems that some clarity is beginning to emerge as regards the scope of the rules, at least in some of the more commonly encountered scenarios. However, it is clear that this remains a focus area for HMRC. With significant further developments expected in several forthcoming Court of Appeal cases, it will clearly be critical in all contexts that appropriate contemporaneous evidence of taxpayers' commercial (non-tax) motivations when entering into debt is recorded, in the expectation of significant HMRC scrutiny.

Limitations of the FTT's jurisdiction

In *John Stenhouse v HMRC* [2023] UKFTT 00635 (TC), the FTT considered the limits of its own jurisdiction to hear appeals regarding penalties that had already been withdrawn, as well as public law arguments.

Background

The individual taxpayer made payments to HMRC between 2019 to 2021 in order to discharge tax liabilities arising from his tax self-assessment. Unfortunately, HMRC had failed to properly allocate those payments to the relevant tax years and subsequently issued a number of late payment penalties.

The taxpayer submitted a notice of appeal against the penalties, but also sought various remedies including orders for costs in the appeal and for compensation in respect of, inter alia, "worry, anger, frustration and time suffered and wasted".

By the time the appeal had been received, HMRC had allocated the various payments and withdrawn all penalties. Consequently, the FTT wrote to the taxpayer highlighting that the remaining matters sought in respect of compensation were outside the limits of its jurisdiction, and suggested alternative forums for redress should the taxpayer intend to pursue his claim for compensation.

The taxpayer, HMRC and the FTT subsequently begun a series of protracted correspondence, which is summarised below:

— The taxpayer challenged the FTT's argument on its lack of jurisdiction and asserted that neither primary nor secondary legislation "create any specific limits to the jurisdiction of the Tax Chamber". The FTT had the same public law jurisdiction as the Administrative Court and the taxpayer had a legitimate expectation that HMRC would deal with his tax affairs properly. In the alternative, the taxpayer cited the FTT's ability under rule 5(3)(k) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (as amended) to transfer his appeal to the UT to deal with his compensation claim.

— The FTT judge corrected the taxpayer's challenge by reference to section 3 of the Tribunals Courts and Enforcement Act 2007 and emphasised the principle that the FTT "has no inherent jurisdiction and can only deal with matters where there is a right of appeal under a statute". The FTT judge also refused to transfer the taxpayer's appeal to the UT, as to do so was to leapfrog the requirement for application for judicial review to the Administrative Court.

— In response, the taxpayer cited the UT decisions in *R & J Birkett (t/a Orchards Residential Home) v HMRC* [2017] BTC 511 and *KSM Henryk Zeman v HMRC* [2021] UKUT 182 (TCC) as authorities to repudiate the assertion that the FTT can never consider questions on public law.

— In response, the FTT judge invited written representations in order to make a decision on the papers in respect of two key issues:
  - whether the FTT had any jurisdiction following HMRC's withdrawal of the penalties; and
  - if not, whether the FTT could and should transfer the proceedings to the UT.

Decision

The FTT judge (and president of the FTT) stressed that the FTT is a creature of statute and its jurisdiction is therefore limited by statute. It can only hear an appeal if prescribed under statute and the taxpayer had misunderstood the decision in Birkett. Turning to other recent judicial authorities such as *Beadle v HMRC* [2020] STC 1058 and *KSM Henryk Zeman*, the FTT judge was at pains to point out that the FTT's ability to invoke public law arguments of legitimate expectation is dependent on the interpretative leeway granted under the relevant statutory scheme. In the circumstances, the taxpayer's appeal had to be struck out as the FTT had no jurisdiction under the relevant statutory scheme in relation to penalties. The FTT also refused to transfer the appeal to the UT, on the basis that there were effectively no proceedings in the FTT to transfer and in any case this would circumvent the requirement for an application for judicial review.

Comment

While the dogged determination of the taxpayer in this case is admirable, the decision re-emphasises that the FTT has no general judicial review jurisdiction, and confirms that the circumstances in which public law arguments may be brought before the FTT remain very limited. It also highlights the importance for taxpayers to seek appropriate professional advice when faced with what is a very complex area of law and procedure.

This means that, while clearly frustrating in terms of time and costs, taxpayers who wish to raise public law arguments in connection with a statutory appeal should ensure that they apply to the Administrative Court for permission to bring a judicial review in respect of that public law challenge (in addition to making their appeal to the FTT). Judicial review applications must be made promptly and, in any event, no later than three months after the grounds for making the claim first arose.

FTT refuses to disapply decision in lead case

In *Muller Dairy (UK) Limited v HMRC* [2023] UKFTT 654 (TC), the FTT denied an application by the taxpayer for a lead case decision to be disapplied in respect of its own appeal. Instead, the FTT made a more limited case management direction.

Background

This decision concerns rule 18 of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (as amended, the "**FTT Rules**"), which relates to "lead cases" and the circumstances in which they can and cannot bind "related cases". In 2018, the FTT directed that the cases of some 60 appellants – including Muller Dairy – should be stayed whilst a lead case, *Jones Bros Ruthin (Civil Engineering) Co Ltd and others v HMRC* [2018] UKFTT 500 (TC), was heard by the courts.

The underlying case concerned a marketed scheme called a "Growth Securities Ownership Plan", allegedly used by all of the appellants, which was designed to reward employees, directors and/or shareholders with pay-outs on instruments said to be "employment related securities" within Part 7 of the Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**"), by utilising purported contracts for differences ("**CFD**") falling within the legislation.

The decision in the lead *Jones Bros* case was released on 20 January 2022. The FTT found that the relevant arrangements did not in fact fall within Part 7 of ITEPA, on the basis that they did not constitute a CFD or contracts similar to a CFD. This was because the arrangements did not involve any real exposure to an underlying asset or metric, which the FTT considered to be a key feature of a CFD.

Rule 18(4) of the FTT Rules provides that:

> Within 28 days after the date that the Tribunal sent a copy of the [lead] decision to a party… that party may apply in writing for a direction that the decision does not apply to, and is not binding on the parties to, that case.

The FTT sent a copy of the decision in *Jones Bros* to the appellant on 20 April 2022, and on 17 May 2022, the appellant made an application for a direction under rule 18(4).

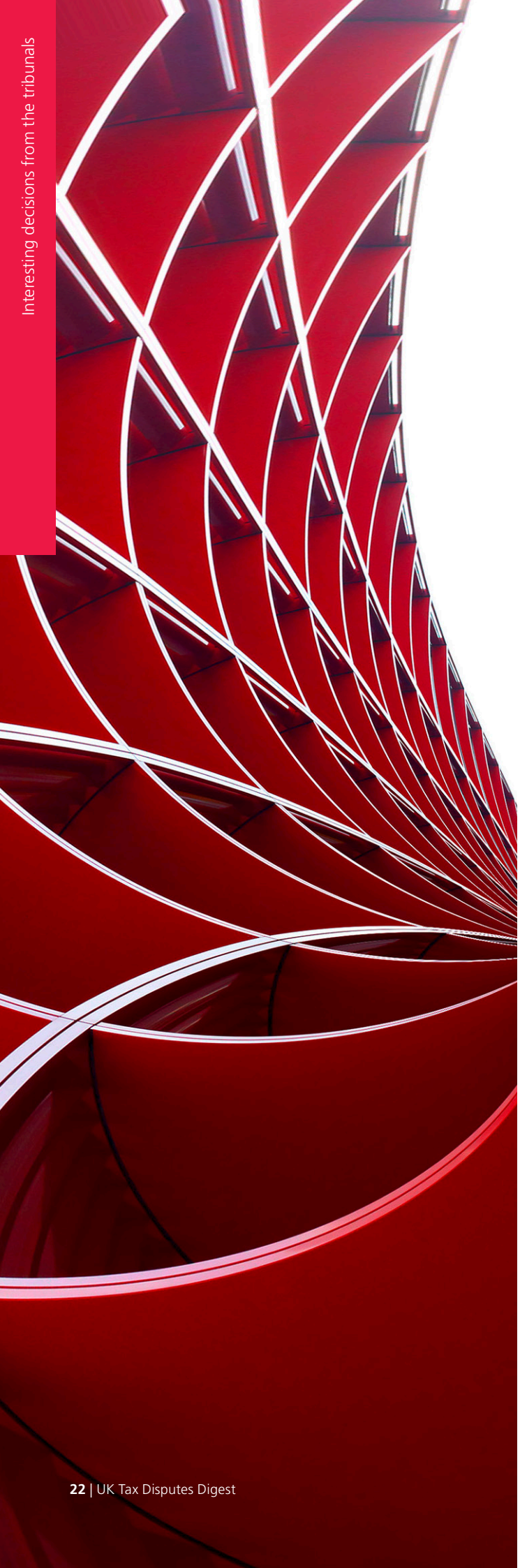
Previous case law has established that a lead case is only binding on the related case "in respect of the common or related issues". However, a direction under rule 18(4) should only be made where the binding effect of the lead case would create "an injustice that cannot be avoided by any other procedural means which preserves the integrity of the lead case process… A lead case direction is not one that is made lightly, nor should it routinely be capable of being cast aside." The effect of setting aside the lead case direction would be that all of the common or related issues of fact or law would fall to be decided afresh at an entirely new hearing, and it would be open to the appellant to argue all issues.

The appellant argued that the rule 18(4) direction should be made on the basis that the arrangements entered into in its particular case had real commercial objectives, and were materially distinguishable from the *Jones Bros* case. HMRC argued that the FTT was aware when it made *Jones Bros* the lead case that the implementation of the scheme was not identical in each case, but had been satisfied that the issues identified were common issues of mixed fact and law. HMRC accepted that the findings of fact in *Jones Bros* were not relevant to the appellant, but suggested that, rather than allowing the appellant's application for the lead case to be set aside entirely, the FTT should instead make a direction under rule 18(5). This rule allows the FTT to give case management directions in respect of cases that are stayed behind lead cases, providing for further steps to be taken in respect of those stayed cases. Here, HMRC suggested that the FTT could direct that the appellant could present evidence to establish that its appeal should be allowed on its particular facts, notwithstanding the binding effect of the determination in *Jones Bros* on the related issues of law.

Decision

On the basis of the case law referenced above, the FTT held that the starting point should always be to preserve the integrity of the lead case. A direction under rule 18(4) should only be made where there was no other procedural solution that was fair to the parties.

In this case, there would be an injustice if the appellant – which had not contended that there was any error of law in *Jones Bros* – was able to distinguish its appeal on the facts, but was prevented from doing so in court because it was bound by the lead case. However, the FTT found that this injustice could be avoided by making a more limited direction under rule 18(5), and it was therefore inappropriate to make a direction under rule 18(4). The FTT directed, under rule 18(5), that a



further hearing should take place so that the FTT could make directions providing for the disposal of the appeal on this basis, and that the parties should liaise in the meantime in an attempt to agree their proposed directions.

Comment

There is clearly a high bar before the FTT will grant a direction under rule 18(4) to disapply a lead case. This is due to the desire to preserve the integrity of the lead case concept; i.e., a decision to stay a number of cases behind a lead case would not in the first instance be made without compelling reasons and, if that direction could easily be set aside, this could call into question the process as a whole.

A better approach, where taxpayers want to avoid having their cases stayed subject to a lead case, will be for the taxpayer to present robust arguments against any application to treat the case behind a lead case in the first place. In this dispute, although the appellant was invited to participate in the initial hearing in which the FTT considered whether to make a lead case direction, it failed to attend or to make any representations. Once that direction had been made, it was likely to be difficult for the appellant to succeed in having it disapplied retrospectively.

FTT partially allows input VAT claim relating to donated PPE

In *3D Crowd CIC v HMRC* [2023] UKFTT 00495 (TC), the FTT held that a company that had donated personal protective equipment ("**PPE**") during the pandemic could only recover a proportion of the associated input VAT, with input VAT incurred for altruistic non-business purposes not being recoverable.

Background

The taxpayer is a community interest company which provided PPE during the first Covid-19 lockdown. By the end of May 2020, the taxpayer had raised around £150,000 and enlisted thousands of volunteers. The taxpayer incurred VAT on supplies made to it in respect of seeking the relevant required accreditation/certification for PPE, materials and general overheads.

Although the intention was to sell PPE in the future, at the relevant time it had not been possible broadly due to delays in the relevant certification/accreditation. The decision was therefore made to donate the PPE in current production to the NHS and care homes, with the intention that this would demonstrate the business' ability to handle large commercial contracts in the future.

The taxpayer duly registered for VAT and HMRC accepted that it was a taxable person for these purposes. However, the taxpayer's claim to recover the VAT incurred on supplies made to it as input VAT was denied by HMRC on the basis that the PPE had been donated, therefore there were no taxable supplies.

Decision

To determine whether the taxpayer was carrying out a business activity, the FTT (citing the decisions in *Gemeente Borsele v Staatssecretaris van Financien* (Case C-520/14) and *Commission v Finland* (Case C-246/08)) held that there must first be supplies made for consideration. Although the consideration charged does not need to yield a profit (or even cover costs), it must be driven at least to an extent by the cost of what it supplies and be more than a notional fee. On the facts, the FTT held that the requirements for a business were present and that the taxpayer was intending to make taxable supplies of PPE in the future. The FTT also confirmed that using volunteers for labour and being partially financed by grants or subsidies will not prevent an entity being in business.

The FTT also held that VAT incurred by the taxpayer on the direct costs of accreditation through the notified body did qualify as input tax, as those costs were incurred in order for the taxpayer to sell PPE in the future and for no other purpose. The fact that the costs were not linked to a a particular supply (and were in the nature of preparing to make future supplies) did not matter. Moreover, it was clear from relevant legislation that an intending trading company can recover input tax.

Likewise, the VAT incurred on the costs of general overheads and producing the PPE had, at least to some extent, a business purpose of putting the taxpayer in a position to win the relevant certification/accreditation and enter into future contracts to supply PPE at a price beyond a nominal amount (i.e., to make taxable supplies). However, the taxpayer was aware when it initially incurred these costs that it would need to donate the PPE in current production. Moreover, the taxpayer's initial purpose had been to supply PPE to help alleviate the national shortage "to do our bit to support the people who are looking after those who need it most". Therefore, producing PPE that could be donated as a contribution to the fight against COVID-19 was held to be another one of the purposes behind the expenditure incurred.

On that basis, it was ultimately held that the VAT incurred by the taxpayer on the direct and immediate costs of relevant accreditation were allowed in full, but that the other VAT incurred on general overheads and the production of PPE would need to be apportioned between the taxpayer's altruistic non-business purpose and business purpose.

Comment

The FTT's decision is useful in confirming the key principles around VAT incurred for business versus non-business purposes. More importantly, the case highlights once again that the impact of the pandemic is still being felt by businesses.

HMRC barred from proceedings for failure to comply with Unless Order

In *Ebuyer (UK) Limited v HMRC* [2023] UKFTT 00611 (TC), the FTT refused HMRC's application for relief from sanctions because of their failure to comply with the disclosure of documents under an automatic Unless Order. The terms of the Unless Order consequently applied to bar HMRC from taking any further part in the taxpayer's appeal.

Background

The dispute concerns appeals made in relation to various HMRC decisions: (i) to deny the taxpayer the right to deduct input tax of approximately £6.7m on the basis that the transactions were connected with the fraudulent evasion of VAT and that the taxpayer knew, or should have known, of the same; and (ii) to assess the taxpayer to VAT of approximately £5.8m.

The appeal before the FTT involves a long history of disputes and delays (on both sides). In respect of the present proceedings, the key facts are as follows:

— In March 2021, the parties agreed case management directions, which included a direction giving effect to a request for disclosure that had been made by the taxpayer. Pursuant to those agreed directions, HMRC were required to disclose the specified information by no later than 26 August 2021.

— On 7 September 2021, HMRC (with the taxpayer's consent) applied for an extension of time to comply with the disclosure of certain information until 26 October 2021, on the basis that their new solicitor needed further time to read into the case and obtain further instructions and advice (although the FTT noted that the evidence suggested the new solicitor had taken over much earlier). This application was granted by the FTT.

— On 26 October 2021, HMRC made another application for a further three months (to 28 January 2022) for compliance with the disclosure directions, this time on the basis that the relevant HMRC officer with conduct of the case was off sick and awaiting surgery. The taxpayer consented, but only on the strict understanding that there would be no further extensions.

— On 10 December 2021, the FTT issued an Unless Order amending the deadline for the original disclosure deadline to 31 January 2022 or, failing that, imposing a new direction requiring provision of all documents on the taxpayer's list of documents by 28 February 2022. The Unless Order provided that, if HMRC failed to meet these deadlines, they would be barred from further participation in the appeal.

— On 5 April 2022, the taxpayer applied for a direction to bar HMRC from further participating in the proceedings on the grounds that they had failed to properly comply with the Unless Order. HMRC conceded the ("inadvertent") breach and, recognising that under the terms of the Unless Order they were automatically barred from further participation, applied for relief from sanctions.

Decision

The FTT, in deciding to refuse HMRC's application for relief from sanctions, applied the three-stage approach set out by the Court of Appeal in Denton v TH White Ltd [2014] EWCA Civ 906, as follows:

1. **Identification and assessment of the seriousness and significance of the failure to comply with the Unless Order**. HMRC argued that their failure to disclose seven documents (which were progress logs of central importance to the case) out of 161 demanded, until three months after the deadline set out in the Unless Order, was neither serious nor significant. HMRC also maintained that the taxpayer should have brought to their attention that the seven documents were missing before it did so. The FTT concluded that there was no such obligation on the taxpayer, and that HMRC's non-compliance was serious and significant (particularly as the relevant documents potentially went to the heart of the dispute and the taxpayer's ability to properly prepare its case).

2. **Consideration as to why the default had occurred**. The FTT decided that there was no good reason for HMRC's failure to ensure timely compliance with the Unless Order, despite HMRC's arguments that this was due to one of their case workers contracting Covid-19. The FTT dismissed this, noting that "HMRC had left the exercise to the last moment…HMRC is a large government organisation and one person's illness should not equate to HMRC being unable to comply with Tribunal directions".

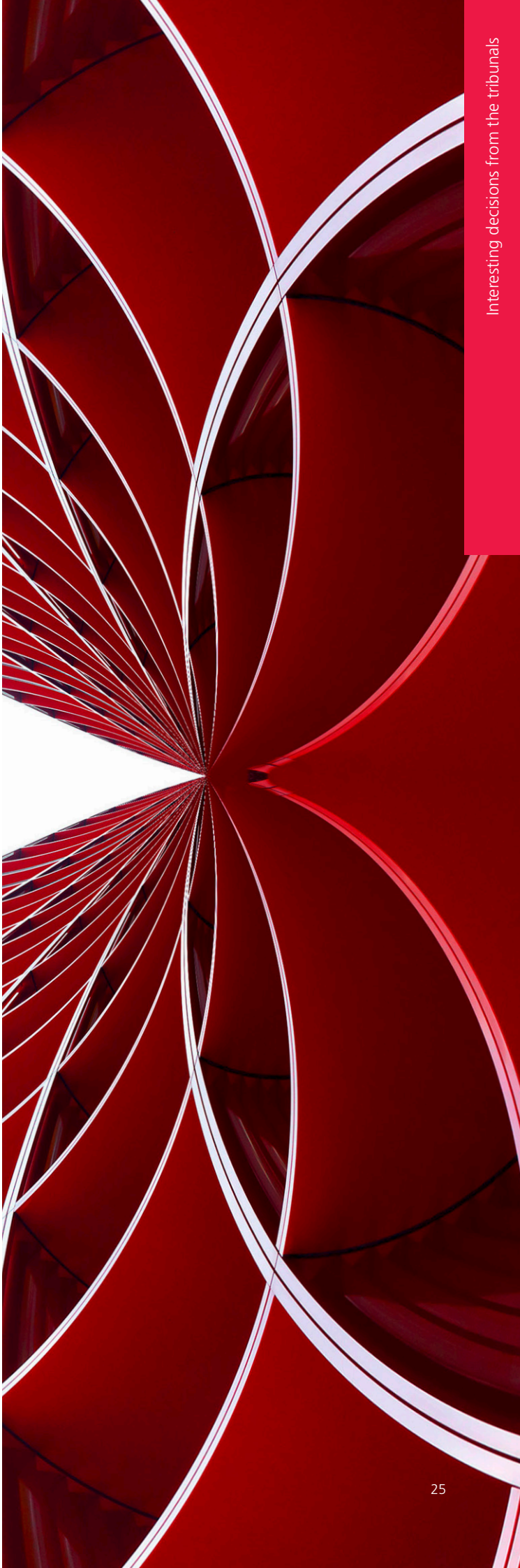
3. **Evaluation of all the circumstances of the case so as to enable the court to deal justly with the application, taking account in particular of the need for litigation to be conducted efficiently and at a proportionate cost and for enforcing compliance with rules, practice directions and orders**. Taking all circumstances into account, the FTT's decision included an observation that the case had been "particularly vexatious and protracted" and that HMRC's failure to disclose the relevant documents had significantly delayed the progress of an already very old appeal.

On that basis, HMRC's application for relief from sanctions was denied and, while the taxpayer's appeal will now proceed, HMRC will be barred from taking further part in these proceedings (i.e., presumably, subject to the current evidence before the FTT and the relevant grounds of appeal, dramatically improving the taxpayer's prospects of success).

Comment

The decision is useful in highlighting the balance that must be struck by the FTT in considering whether to bar HMRC from proceedings – weighing up the clear public interest in HMRC being able to challenge appeals where tax is at stake, versus the importance of court time being used effectively and of judicial orders being followed in a timely manner.

Decisions such as these are fact specific, and the FTT's decision in this case should be seen in the wider context of the parties' long dispute. However, the FTT's decision that HMRC's failures outweigh the public interest in the fact that approximately £6.7m of VAT was at stake in this appeal demonstrates the importance placed on complying with directions regarding disclosure – particularly in respect of Unless Orders, which are expected to "galvanise" parties into action.



Other developments

Report on historic non-compliance around R&D tax reliefs

Concerns around significant non-compliance in relation to R&D reliefs have been well-publicised over the past couple of years. In July 2023, HMRC published a report setting out the findings of their investigations into historic non-compliance, as well as the strategy for improving compliance in the future.

The report asserts that the overall levels of non-compliance are significantly higher than originally estimated. Calculated from the findings of a mandatory random enquiry programme, the updated estimate
of error and fraud for 2020 to 2021:

— for both R&D reliefs is now 16.7% (£1.13 billion) (up from the previous estimate of 3.6% or £336 million);

— for the SME scheme is now 24.4% (£1.04 billion) (up from the previous estimate of 5.5% or £303 million); and

— for the RDEC scheme is now 3.6% (£90 million) (up from the previous estimate of 0.9% or £33 million.

On that basis, the risk of non-compliance appears significantly higher for claims made under the SME scheme. Other key non-compliance risk factors include small claims (claims for under £10,000 expenditure had error and fraud rates of over 75% of the claim value, as opposed to around 75% compliance rates for claims over £1 million), and first-time claims (with 38% of the £590 million value of first-time claims non-compliant, compared to 22% of the £4.01 billion claim value for companies that had previously made claims).

The stated strategies for tackling non-compliance include both operational changes (such as doubling the number of people working on R&D compliance over the past three years, using nudge letter campaigns and conducting criminal investigations where appropriate), and policy changes (such as requiring claims to be made digitally and be accompanied by additional information, reducing the amount of payable relief in the SME scheme, and tackling non-compliance "encouraged" by agents by making it mandatory for claimants to inform HMRC which agent was involved in producing their claim). The report notes that HMRC are focusing on the areas of the highest risk, including businesses considered unlikely to be eligible for R&D relief. The nudge letters sent to care and nursing homes (see below) are an example of this.

HMRC annual report 2022-23

The HMRC annual report and accounts (2022-2023), published on 17 July 2023, revealed that HMRC generated £814 billion in total tax revenue during the financial year. HMRC also reported that they managed to maintain a long-term reduction in the UK's tax gap from 7.5% in 2005 to 2006, to 4.8% in 2021 to 2022.

Regarding compliance yield, which is additional tax generated through tackling avoidance, evasion and other non-compliance, a figure of £34 billion was generated (up from the previous year's figure of £30.8 billion). HMRC largely attributed this increase to their investment in over 4,000 new compliance officers in 2021-2022, as well as their renewed focus on serious fraud criminal investigations. In light of this, HMRC saw the average value of their criminal cases rise to £6.2 million, almost three times what it was in 2016-2017.

In terms of litigation, there were 12,332 new appeals were notified to the FTT. Approximately 39,500 appeals were in progress as at 31 March 2023 (with 34,000 Zof these being appeals to the FTT that have been stood over).

HMRC contact groups potentially affected by Pillar 2 reforms

Given that the UK's implementation of Pillar 2 (in the form of the new multinational and domestic top-up taxes) is fast approaching, HMRC have announced that they are contacting groups that may be affected by the reforms. Additionally, a new Pillar 2 compliance team has been set up to assist in-scope entities and groups. The compliance team is intended to work with the "adviser community", to help HMRC understand the key issues for groups, and what action can be taken to overcome those problems.

HMRC publish annual list of tax avoidance decisions

Each year, HMRC publish a list of litigation decisions in which they consider tax avoidance was involved. The list splits such "tax avoidance decisions" into four categories (those where the substantive issue before the court was tax avoidance, those relating to procedural rules, cases which relate to the Disclosure of Tax Avoidance Schemes (DOTAS) legislation and judicial reviews of substantive administrative decisions linked to anti-avoidance legislation).

According to the report, HMRC won 85% of tax avoidance cases in 2022 to 2023 (including where the outcome is noted as a "part-win" rather than a "win"). The list of "substantive" tax avoidance decisions includes the recent cases relating to the loan relationship "unallowable purpose" rule (see for example the UT's decision in JTI Acquisitions Company in the "Interesting decisions from the tribunals" section above).

Updated guidance on relying on incorrect advice or information

HMRC have updated their guidance "how HMRC advice and information can help you" by expanding the list of factors they expect to be present in order to be bound by incorrect advice or information provided by HMRC to taxpayers. The additional factors are that: (i) it must be reasonable for the taxpayer to expect to rely on the incorrect advice or information; and (ii) it must be "very unfair" for HMRC to act in a different way from the advice and information given. Prior to the update, the guidance stated that HMRC would consider whether: (i) the taxpayer had told them about the relevant facts; (ii) HMRC's advice was clear and certain; (iii) the taxpayer had already relied on the advice and information and would be 'worse off' if HMRC did not act according to it.

Additionally, the guidance now incorporates a list of the type of communications constituting advice or information from HMRC, which includes both communications directly with the taxpayer (e.g., letters, phone calls and webchat) and publicly available information (e.g., pages on gov.uk and posts on Twitter).

Notwithstanding HMRC's guidance, the application of legitimate expectation and public law principles in general to tax is an extremely complex area based on extensive case law principles. Taxpayers who think they may wish to pursue public law arguments should seek appropriate professional advice as a matter of urgency (judicial review applications must be made promptly and, in any event, no later than three months after the grounds for making the claim first arose).

HMRC service levels

HMRC's service statistics for April to June 2023 have been published. The report notes that £814 billion in tax revenue was generated in 2022 to 2023, representing a year-on-year increase of 11.3%, and that the tax gap (the amount of tax revenue lost to the Exchequer through error, fraud or other forms of non-compliance) has been reduced to 4.8% in 2022 to 2023 in comparison with 7.5% in 2005 to 2006.

However, the report accepts that service levels in relation to contact by phone and post are not at a satisfactory standard – in particular, in the period between April and June 2023, only 63.4% of callers wishing to speak to an HMRC adviser were able to. The proportion of customer correspondence responded to within 15 working days increased to 72.7% in 2022 to 2023, a significant increase from 45.5% in 2021 to 2022, although it continues to be the case that more correspondence fails to meet this standard than advisers would expect. HMRC's answer to the continuing service level issues is to move away, for simpler queries, from those traditional contact methods to digital services which are available 24/7. This includes a digital assistant which automatically helps customers to find the information they are looking for and, if further help is needed, links the customer to an adviser through webchat. Notably, from 12 June 2023, HMRC piloted closing its self-assessment helpline for 3 months so that advisers could focus on other priority areas during the 'quietest' period of the year.

New guidance on giving evidence to tribunals from abroad

HMRC have published guidance on witnesses or people appealing cases who are abroad and who wish to given evidence via video link. The guidance notes that the rules around taking or giving evidence in tribunals are specific to countries or territories and contains a list of the rules for 36 different countries. Residents or citizens of Lithuania, Luxembourg, South Sudan and Turkey, for example, are not able to give evidence by video link to UK tribunals in that respective country, either as a witness or when appealing a case. Several jurisdictions require permission to be requested on an individual basis, and many allow citizens and residents to voluntarily give evidence. Those giving evidence are directed to contact the relevant tribunal should the country they wish to give evidence from not be listed.

Revised practice guidance on the conduct of UT proceedings

New guidance on the conduct of proceedings in the UT has been published, to replace guidance on the same which was released during the Covid-19 pandemic. The guidance contains detailed information on the format, length, and content of skeleton arguments. Similar detail is provided on hearing bundles, which should all be provided in electronic format, with the core bundle to be additionally provided to the Tribunal in hard copy format. In future, the default position for hearings of half a day or less (i.e., most permission to appeal applications and other procedural hearings) will be remote hearings, although parties are able to ask the UT to consider their reasons for an in-person or hybrid hearing. The UT will be able to record the hearing, but parties will remain unable to do so.

Late interest payments

HMRC are required by statute to charge interest where tax is not paid by the required date. The rate of interest charged fluctuates but tracks at 2.5% above Bank of England rates. In contrast, the rate of repayment interest is set at the base rate minus 1% (with a minimum limit of 0.5%). The means that, with effect from 22 August 2023, the rate was raised to 7.75% for late payment interest and only 4.25% for repayment interest.

Late payment interest will continue to accrue until tax is paid, even where it is agreed with HMRC that payment of tax may be postponed pending the outcome of a statutory appeal or review. 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 an investigation or 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). Failing that, the only recourse is likely to be judicial review. 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.

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 have launched several new nudge letter campaigns on various issues, as summarised below.

Persons with significant control (June 2023)
HMRC's Wealthy Mid-sized Business Team is sending letters to individuals listed at Companies House as being "persons with significant control" ("PSCs") who have either omitted to file a self-assessment tax return for tax year 2021/22 or have filed a return for tax year 2021/22 or 2022/23 which HMRC suspect does not reflect all sources of the recipient's income and gains.

The letter to those who have not filed a self-assessment return reminds recipients that the deadline for the 2021/22 return has now passed (being 31 January 2023) and requests either that they submit a return by 18 August 2023 or that they contact HMRC stating the reasons why no return is required. The letter to those who have filed a return – but which HMRC suspect is inaccurate – similarly directs the recipients to amend their tax return for 2021/22 by 18 August 2023, and requests they check that their return for 2022/23 includes all sources of income and gains.

Risks of VAT errors in relation to fuel and power supplies (August 2023)
HMRC's Large Business Team has issued letters to energy businesses asking them to check their systems and processes for accounting for VAT on supplies of fuel and power, as HMRC suspect some businesses are doing so incorrectly. The letter notes that the reduced rate of VAT for supplies of domestic fuel or power applies only to small amounts of energy. The concern is that billing systems are in place which do not aggregate multiple supplies of fuel and power to one customer before determining whether the de minimis limit applies. Recipients are requested to read the relevant VAT Notice, review their billing and accounting systems, inform HMRC if they have made reduced rated supplies because the de minimis test was met, correct any relevant VAT mistakes, and inform HMRC once those actions have been taken.

Provisional self-assessment returns (August 2023)
As part of HMRC's programme to engage with tax agents "in order to maintain compliance standards", HMRC are writing to agents who submitted client self-assessment returns for tax year 2021/22 which included provisional figures, to remind them to review the figures and amend them with the actual figures. The letter notes that it is not sent as part of a formal enquiry or disclosure process, but reminds recipients that the deadline for self-assessment return amendments for the relevant tax year is 31 January 2024, and that, in order to aid "workload management", agents are requested to submit the actual figures at specified dates during winter 2023. HMRC will contact agents within two weeks for an update.

Non-resident landlord liabilities – non-residential property (August 2023)
Letters have been issued to non-resident companies owning non-residential property in the UK, and which have not registered for income tax or corporation tax. Recipients are requested to check they have accurately declared the tax which the company is liable for in the UK, make a disclosure to HMRC if they have failed to do so and, whether or not they believe they need to make a disclosure, complete and send to HMRC an enclosed "certificate of tax position". The deadline for beginning the disclosure process or informing HMRC that a disclosure does not need to be made is set at 40 days from the date of the letter.

R&D tax claims in the nursing and care home sectors (August 2023)

Letters have been issued to directors of companies in the nursing and care home sectors as part of HMRC's increased compliance activity around R&D claims. The letters set out HMRC's belief that companies in this sector are unlikely to meet the relevant criteria and have been targeted by agents and third parties to make ineligible R&D claims. The letters remind recipients that R&D relief is available for the costs of activities seeking scientific and technological advances in a particular field, and not simply for the claimant's own business. Recipients are provided with a list of factors to assist them in considering whether a prior R&D was eligible and are warned about R&D agents who operate on a "no win no fee" basis.

Holdover relief claims (September 2023)

HMRC are writing to taxpayers who included a capital gains tax holdover relief claim in their 2021 to 2022 self-assessment tax return and either did not submit the required claim form, or submitted that form unsigned, meaning that it is invalid. Recipients are required either to amend the relevant return or to submit a correctly completed and signed claim form within 30 days of the letter. The letter warns that failure to do so may result in HMRC amending the return or opening an enquiry into it, and that interest and penalties may be charged if additional tax is determined to be due.

Additional Information Forms for R&D tax relief claims (September 2023)

HMRC are writing to taxpayer companies (and their agents) who have submitted R&D tax relief claims without the accompanying Additional Information Form, which has been required for both SME R&D tax relief and the R&D expenditure credit since 8 August 2023. The letter refers to the relevant legislation and states that, due to the omission of the form, the claim will not be accepted. Should the recipient still wish to make a claim for the relevant accounting period, it is suggested that the taxpayer or their agent (as applicable) should file an amended CT600 corporation tax return with the completed form. In the meantime, HMRC will remove the invalid R&D claim from the taxpayer's Company Tax Return and provide a notification that the R&D correction has been made and of any revised tax calculations.

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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