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UK Tax Disputes Digest

Spring 2024

Contents

Introduction

Welcome to the spring 2024 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.

As with previous editions, we have seen a continued increase in HMRC activity across various areas. 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 these developments, including the latest in relation to permanent establishment and diverted profits tax and the latest series of HMRC nudge campaigns.

We also cover a number of notable tax cases and other interesting procedural decisions. This includes the most recent case law development on the unallowable purpose test within the loan relationship rules and a case from the tribunals in which the taxpayer alleged that HMRC was seeking to "cherry pick" by bringing the weakest case before the tribunal.

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: *Dolphin Drilling* – an incidental consequence for main purpose tests?

The recent Court of Appeal decision in *HMRC v Dolphin Drilling Ltd* [2024] EWCA Civ 1 provides a new perspective on the meaning of the word, "incidental" in UK tax legislation. It may also provide some clues as to the Court of Appeal's likely stance in relation to main purpose tests.

Background

The context of the case is that of the offshore oil industry and the potential application of provisions of Part 8ZA of the Corporation Tax Act 2010, which impose a "hire cap" (at section 356N) which limits a contractor's ability to bring into account payments it makes under a lease of an asset from an associated person.

The taxpayer ("**Dolphin**") leased an asset ("**the Borgsten**") from an associated company and in turn provided it to Total, the operator of the Dunbar oil platform ("**the Dunbar**"). The Borgsten had been converted from a drilling rig and was equipped to provide several services in connection with the preparation of the Dunbar for drilling and, subsequently, the operation of the Dunbar for drilling. The Borgsten was moored alongside the Dunbar and operated as a tender support vessel, providing tender assisted drilling services. It was also used for the provision of accommodation for some of those who worked on the Dunbar.

The issue at stake is whether Dolphin's payments to the associated party were subject to the hire cap. This fell to be determined according to whether it was "reasonable to suppose" that the use of the Borgsten for accommodation "is unlikely to be more than incidental to another use, or other uses, to which [the Borgsten] is likely to be put".

HMRC decided that this test was not met. The taxpayer appealed to the First-tier Tribunal (Tax Chamber) ("**FTT**") which allowed its appeal. HMRC appealed to the Upper Tribunal (Tax and Chancery Chamber) ("**UT**"), but lost and subsequently appealed to the Court of Appeal, where HMRC's appeal succeeded.

In the Court of Appeal, the main focus was on what it means for one use of an asset to be "incidental" to another. The Court found that being secondary or subordinate is not what incidental means. Instead, use A is only incidental to use B if use A is "tied in to" use B and that this is not the case if use A is an unconnected and independent purpose in itself. In other words, use A is incidental to use B, "if it arises out of use B, something that is done because of use B, or in connection with use B, or as a by-product of use B". The issue was therefore whether the use of the Borgsten to accommodate those working on the Dunbar "was an independent end in itself (of some significance), unconnected with its other uses, or whether it was something that arose out of its other uses".

The Court concluded that the use of the Borgen as accommodation for those working on the Dunbar was not simply something that arose out of its use as a tender support vessel providing tender assisted drilling services. Instead, it was an independent end in itself, of some significance. The provision of accommodation may have been a secondary use, but it was a "significant and independent use and not incidental to its other uses". The effect of this conclusion was that the hire cap applied.

Other uses of "incidental" in UK tax legislation

In considering any wider ramifications of this case, a starting point is other contexts in which UK tax legislation uses the term "incidental".

An example of such a context is the transfer of assets abroad legislation, which includes an exemption (at condition B of section 737(4) of the Income Tax Act 2007) for genuine commercial transactions, in circumstances where it would not be reasonable to draw the conclusion that any one or more of the transactions was more than incidentally designed for the purpose of avoiding liability to taxation.

The Court of Appeal's judgment in *Dolphin Drilling* perhaps adds weight to an argument that in order for the exemption in condition B to be available, any tax avoidance must be no more than "incidental", as such term is interpreted in *Dolphin Drilling*. Broadly, this would now seem to depend upon an argument that any tax benefit is merely a by-product, as opposed to an independent objective (however secondary) in itself.

Issues for "main purpose" tests

Anti-avoidance case law is a significant area of current focus, with several forthcoming appeals likely to focus on "main purpose" tests. Although these tests tend not to use the term "incidental", they concern (broadly) whether the taxpayer had a "main purpose" of avoiding tax. Might it be said that obtaining a tax benefit which is incidental to a main (commercial) purpose, cannot be a main purpose itself?

A number of appeals which have been, or are due to be, heard during 2024 potentially involve such issues. *Burlington Loan Management DAC v HMRC* [2022] UKFTT 290 (TC) relates to a principal purpose test in a double tax treaty. *BlackRock HoldCo 5, LLC v HMRC* [2024] EWCA Civ 330 – discussed later in this edition – relates to the unallowable purpose test in the loan relationship legislation, as does both *JTI Acquisitions Company (2011) Limited v HMRC* [2022] UKFTT 166 (TC) and *Kwik-Fit Group Limited and others v HMRC* [2022] UKUT 00314 (TCC). It will be interesting to see whether *Dolphin Drilling* is cited as authority in those appeals which have yet to be heard, so as to become more broadly influential to the development of anti-avoidance case law tests.

Comment

Whilst this is a case which has undoubtedly significant implications for contractors in the oil industry, it is also a case which has potentially far-reaching implications for UK tax legislation more widely. First, issues arise in relation to other legislation which uses the term "incidental". Secondly, it will be interesting to see whether this line of thinking is reflected in the Court's consideration of forthcoming appeals relating to "main purpose" tests. In many contexts, the possibility of further developments in this area add an additional layer 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

Brown and another v HMRC [2024] EWCA Civ 92

The Court of Appeal dismissed the taxpayers' appeal in this case which relates to a marketed SDLT avoidance scheme, in which the taxpayers acquired a property from an unconnected seller via an unlimited company.

The taxpayers subscribed for shares in the unlimited company, contributing cash in an amount equating to the purchase price of the relevant property.

Subsequently, the company purchased the property from the third party seller and simultaneously the company reduced its capital by making a distribution in specie of the property to the taxpayers. The company then executed a transfer to the shareholders. The company filed a land transaction return claiming relief from SDLT. Mr and Mrs Brown made no land transaction return on the basis that no chargeable consideration had been given for the transfer of the property to them, so none was required.

The Court rejected the taxpayers' argument that the sub-sale rule then in force (section 45 of the Finance Act 2003) meant that the original contract between the seller and the company should be disregarded for SDLT purposes. Further, the Court rejected the taxpayers' argument that because there was no consideration paid in respect of the distribution in specie from the company to the taxpayers, no SDLT was payable.

The Court noted that a purposive approach to interpretation is applicable to all statutes and therefore should be applied in this case to the relevant SDLT provision. From an economic perspective, the taxpayers had parted with £955,000 and in return acquired the freehold. The mechanics with which they had acquired the freehold should not be regarded as determinative. Accordingly, the subscription monies constituted indirect consideration and were subject to SDLT.

Northumbria Healthcare NHS Foundation Trust v HMRC [2024] EWCA Civ 177

The Court of Appeal allowed the taxpayer's appeal in this case which concerns whether VAT is due to be charged by NHS foundation trusts which levy charges to park at their sites. The appeal concerned car parks operated by Northumbria Healthcare NHS Foundation Trust (the "**Foundation Trust**") itself, not those where operation of the car park was outsourced to a third party.

NHS hospitals which operate their own hospital car parks should ensure that users can park "as safely, conveniently and economically as possible", according to guidelines issued by the Department of Health in 2015, referred to as "The 2015 Parking Principles".

Whether VAT was chargeable on the provision of hospital car parking by the taxpayer in this case turned upon whether the requirements of section 41A of the Value Added Tax Act 1994 were met. In determining this, the first issue was whether the Foundation Trust was acting as a public authority. Broadly, this turned upon whether a special legal regime affected the Foundation Trust's provision of car parking. The 2015 Parking Principles were held to constitute a special legal regime for this purpose.

The second issue was whether distortion of competition would arise if VAT were not charged. In the Court's view, HMRC had not provided sufficient evidence at tribunal that such a distortion would arise. Distortion of competition could not be assumed based simply on participation in the car parking market. Instead, the Court said that suitable evidence might have comprised some form of economic assessment enabling the tribunal to conclude that non-taxation would have an effect on the market – most obviously through lower prices – and that this would distort competition in a non-negligible way.

Although the VAT at stake in this appeal was relatively limited, around 50 similar appeals were stayed behind it and, overall, the tax at stake for past periods is understood to be in the region of £70m.

The Prudential Assurance Company Ltd v HMRC [2024] EWCA Civ 300

The Court of Appeal dismissed the taxpayer's appeal from the UT, holding that VAT was chargeable on performance fees for continuous investment management services provided by Silverfleet Capital Limited ("**Silverfleet**") to the taxpayer during a time when the two companies were in the same VAT group but which were not invoiced or paid for until a time when the two companies were no longer in the same VAT group.

The taxpayer unsuccessfully argued that, as the real-world supplies had been performed at a time when the companies were in the same VAT group, the supplies were to be disregarded under section 43(1) of the Value Added Tax Act 1994 ("**VATA 1994**") and that Regulation 90(1) of the Value Added Tax Regulations 1995 (the "**VAT Regulations 1995**"), which deems the time of continuous supplies of services to be when paid or invoiced, is not relevant here as there is no supply to which it can apply.

The Court held that it is first necessary to apply the time of supply rules to determine when the supply is treated as having been made. The disregard under section 43 VATA 1994 will only be in point if the companies are in the same VAT group at the time the supply is treated as having been made. This decision is arguably at odds with the 1996 Court of Appeal decision in BJ Rice & Associates v Customs and Excise Commissioners [1996] STC 581 which held that the time of supply rules determined "when, but not whether" VAT is chargeable and "the existence of a chargeable transaction has to be determined at a time when the supply is actually made". However, several subsequent cases qualified Rice to the extent that the Court did not consider itself bound by the decision. Furthermore, Rice concerned a taxpayer who was not registered for VAT when it made supplies and so was entirely outside the scope of the VAT system. Conversely, Silverfleet was within scope when it made supplies and would have been required to be registered in its own right as a taxable person had it not belonged to a VAT group.

Hargreaves Property Holdings Limited v HMRC [2024] EWCA Civ 365

The Court of Appeal dismissed the taxpayer's appeal in this case which concerned whether interest on recurring loans was yearly interest (in circumstances where the duration of individual loans was less than a year) and whether the UK tax resident company which was the recipient of the interest was beneficially entitled to the interest, so that the UK to UK withholding tax exemption should apply.

The borrower, a UK resident taxpayer which was the parent of a group engaged in UK property investment, financed its activities with loans from several lenders. Each lender assigned its right to interest and principal to a Guernsey entity and, shortly before the interest was due, the interest was further assigned to a UK incorporated and tax resident company ("**Houmet**"). A day or two after assignment, interest was paid and principal repaid and then the relevant lender advanced a new loan (of an equal or greater amount) funded by the repayment.

The Court concluded that the loans were, in reality, of a long-term nature, so as to be potentially subject to withholding tax. Further, the UK to UK withholding tax exemption (in section 933 of the Income Tax Act 2007) did not apply, because Houmet was not beneficially entitled to the interest assigned to it. This conclusion was reached on the basis that, "viewed realistically, the transactions conferred [no] benefit of an entitlement to the interest". This is an important conclusion and the Court's analysis on this point is likely to be of relevance in other contexts.

Blackrock Holdco 5, LLC v HMRC [2024] EWCA Civ 330

The Court of Appeal (largely) dismissed the taxpayer's appeal in this case which relates to transfer pricing and unallowable purpose in the context of acquisition debt. The case concerns the acquisition structure used for the acquisition by the BlackRock group of the US business of Barclays Global Investors and, in particular, the deductibility for UK tax purposes of interest payable on $4 bn of intra-group loans.

HMRC challenged the claim to deduct interest on the relevant loan notes on two grounds: (i) the transfer pricing rules in Part 4 of the Taxation (International and Other Provisions) Act 2010; and (ii) the unallowable purpose rule in section 441 of the Corporation Tax Act 2009.

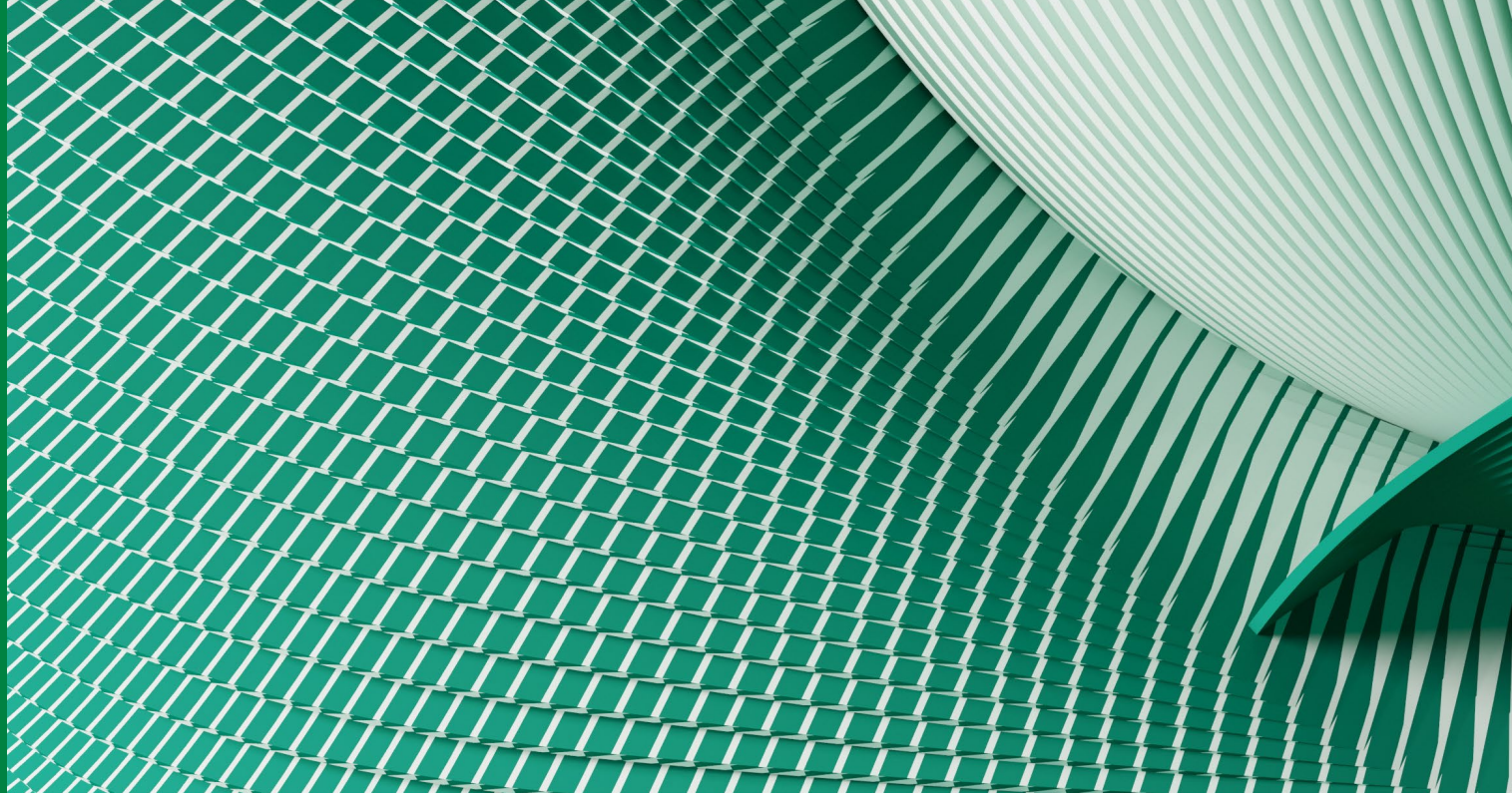
In overview, on the transfer pricing issue HMRC argued that the loans would not have been made at all between parties acting at arm's length. On the unallowable purpose issue, HMRC argued that relief should be denied because securing a tax advantage was the only purpose of the relevant loans.

The acquisition structure included several newly formed Delaware LLCs, one of which (LLC5) was tax resident in the UK by virtue of central management and control. The dispute concerns the deductibility of interest payable by LLC5 on loans made to it by another LLC within the acquisition structure (LLC4). If that interest were deductible, it would give rise to non-trading deficits on loan relationships which could be surrendered to UK members of the BlackRock group to set against their taxable profits. LLC5 had no taxable income, because its only receipts were of dividends on preference shares which were exempt from tax.

On transfer pricing, the principal issue before the Court was whether, in determining if an independent lender would be prepared to lend, the transfer pricing provisions permit the existence of third party covenants to be hypothesised where those covenants are not present in the actual transaction. The Court concluded that in the real transaction, LLC4 had no need of the relevant covenants. Its relationship of control meant that it had the ability to control the relevant risks itself, without the need for such covenants. Therefore, it was decided that interest on the loans should not be restricted under the transfer pricing rules.

On unallowable purpose, the Court concluded that the sole reason for the existence of LLC5 (a UK based entity interposed into an otherwise solely US structure) was to enter into the loans, in order to obtain tax advantages for the BlackRock group. LLC5 also had a commercial purpose in entering into the loans; it was set to make very significant profit from its investments. However, from a wider group perspective, the Court concluded that the commercial purpose of LLC5 was in truth a by-product of the tax planning.

The Court held that the entirety of the debits should be attributed to the tax avoidance main purpose, with the result that the deductions should be disallowed under the unallowable purpose rule.



Interesting decisions from the tribunals

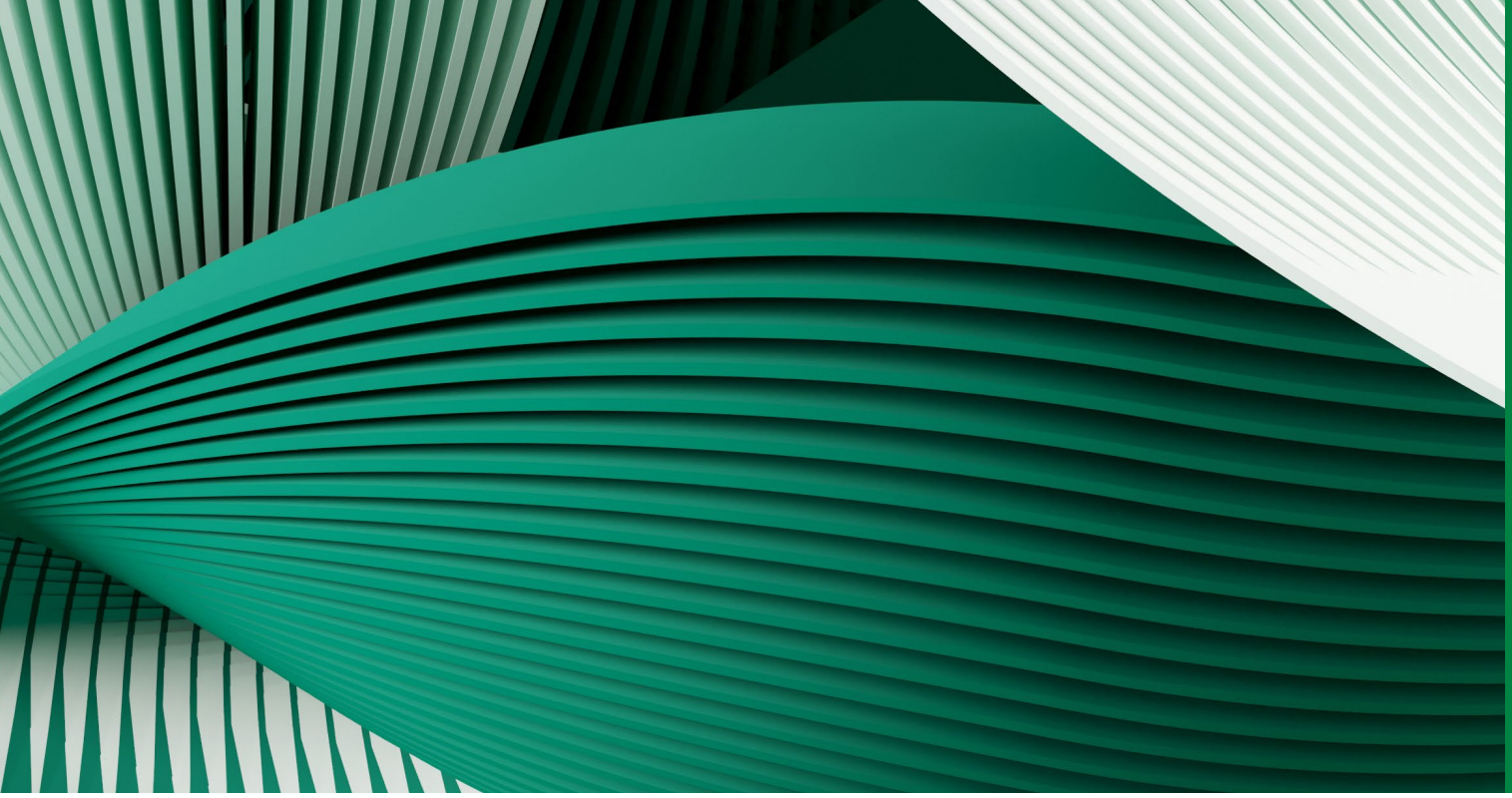
FTT allows HMRC's stay application, despite taxpayers having sought to argue that HMRC was seeking to "cherry pick" by choosing the weakest case to bring before the tribunal

In *Paul Hunt and others v HMRC* [2024] UKFTT 00078 (TC), the FTT allowed HMRC's application to stay the taxpayers' appeals against the application of the transactions in securities ("**TIS**") legislation to a reduction of capital, following an interesting discussion of the circumstances in which the tribunal may allow a contested stay application.

Background

The appellants had sold shares in three companies to a holding company, Golf Holdings Limited ("**GHL**"), in a share for share exchange. Subsequently there was a capital reduction in GHL, involving the cancellation of one million shares and the payment of £10 per share to the appellants, paid in instalments. The appellants had reported the transaction to HMRC as capital gains. However, HMRC wrote to the appellants, indicating their view that the TIS legislation might apply to the capital reduction and counteraction notices and assessments to tax were subsequently issued.

The taxpayers appealed on the grounds that the assets distributed or transferred by the company represented a return of sums contributed by subscribers falling within section 685(6) of the Income Tax Act 2007 ("**ITA 2007**"), or in the alternative, that because the consideration represented share capital, it did not comprise the value of assets available for distribution.



HMRC applied for a stay of these proceedings until 30 days after the final determination of the definition of "relevant consideration" in section 685(4) ITA 2007 and whether the safe harbour in section 685(6) ITA 2007 applies (the "**Relevant Consideration Issue**") in the earlier appeal. HMRC argued that the tribunal hearing the earlier appeal (and any higher tribunal or court on appeal) will set out the relevant principles on this issue. This might mean that these appeals could be resolved without litigation, reducing time and cost. They also argued that a stay of these appeals would avoid the possibility of there being a number of conflicting decisions on this issue. Further they argued that the decision in the earlier appeal would be of material assistance in resolving these appeals. Finally, they argued that neither party would be prejudiced by a stay.

The appellants had objected to the stay application on various grounds, arguing that HMRC is cherry-picking and choosing the weakest case to bring before the tribunal. The appellants had also argued that the grounds of appeal were not the same in the earlier appeal.

On the cherry-picking point, HMRC countered the appellants' argument with an assertion that these appeals would have been held before the other appeal, had the appellants' counsel been available on the relevant dates.

Decision

The FTT allowed HMRC's stay application and concluded as follows. HMRC was not cherry picking the weakest case. Instead, these appeals needed to be heard after the earlier appeal due to the availability of the appellants' counsel. The tribunal concluded that there is no material difference between the circumstances of the reduction of capital in these appeals and the own share purchase in the earlier appeal.

It was held that determination of the Relevant Consideration Issue in the earlier appeal would be of material assistance in resolving the issues in these appeals. It was noted that the earlier appeal involves some grounds of appeal which are not relevant to these appeals, so that there was a theoretical possibility that the earlier appeal could be decided without consideration of the Relevant Consideration Issue.

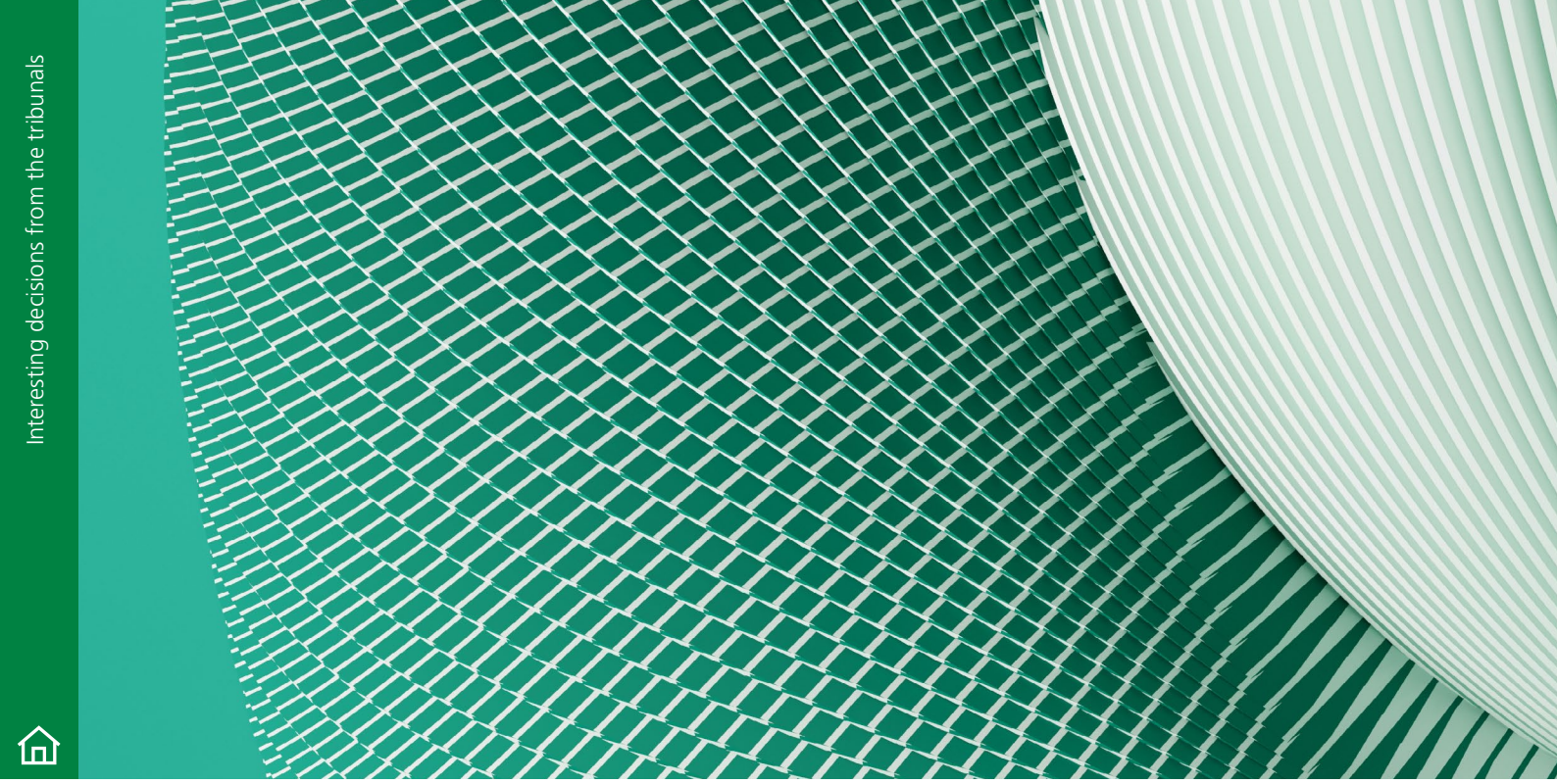
However, now that it was clear that these appeals turned upon the Relevant Consideration Issue, the tribunal indicated that it would deal with the Relevant Consideration Issue fully in its decision on the earlier case.

The tribunal rejected the appellants' submissions that they should be entitled to be represented at the hearing of the earlier appeal and make submissions at that hearing.

Staying the appeals would avoid the possibility of multiple, and conflicting, first instance decisions.

Comment

This case is a useful indicator of the approach a tribunal will take in relation to a contested stay application, in light of the Tribunal Procedure Rules which stipulate that it is necessary to have regard to the overriding objective to deal with the case "fairly and justly" which includes making directions which are proportionate to the importance of the case, the complexity of issues, the anticipated costs and resources of the parties and avoiding delay so far as compatible with the proper consideration of the issues.



UT decides not to have regard to an unpublished decision of the FTT

The UT has dismissed the taxpayers' appeal in the capital gains tax case *Haworth and others v HMRC* [2024] UKUT 00058 (TCC), which involves a "round the world scheme" relating to overseas family trusts. In an annex to its decision, the UT separately considered whether it should have regard to an unpublished FTT decision, upon which HMRC sought to rely.

Background

The first and second appellants were the settlors of separate family trusts which engaged in a tax planning arrangement known as the "round the world" scheme. The aim was that the trustees of the family trusts should avoid capital gains tax on disposals of the shares in a company, upon its flotation. It was common ground that the planning only worked if, amongst other things, by the time of the disposal the place of effective management (the "**POEM**") of the trusts was in Mauritius.

The FTT had concluded that the POEM of the trusts at the relevant time was the UK, but the taxpayers' argument on appeal was that the FTT had applied the wrong test, based upon the relevant authorities.

HMRC's skeleton argument included reference to an (as then) unpublished decision of the FTT, the decision in which had been released to the parties (unrelated to the parties in this appeal) but not published. Counsel for the taxpayer objected to HMRC relying on an unpublished decision.

Decision

The UT concluded that the FTT made no error of law in the test it applied in order to determine the POEM of the trusts. As regards HMRC's attempt to rely upon an unpublished decision, the UT refused to grant permission for HMRC to do so.

Decisions of the FTT may, in principle, be persuasive as regards the UT. However, here, the UT had regard to, "the overriding objective of dealing with cases fairly and justly" in concluding that reliance ought not to be placed upon the unpublished FTT decision.

One factor which led to this conclusion was that HMRC will be aware of all unpublished decisions of the FTT, whereas most taxpayers and their advisers will not be so aware. HMRC's reliance upon an unpublished decision may therefore give rise to a perception that HMRC has an unfair advantage in proceedings. Further HMRC could in principle refer only to unpublished decisions which are favourable to it, choosing not to draw attention to any unfavourable unpublished decisions.

In this particular case it was accepted that there was no specific prejudice to the appellants as a result of HMRC's attempt to rely on the unpublished decision. The taxpayers were well represented and had received notice, together with a copy of the unpublished decision, prior to the hearing.

Finally, there was ample authority before the UT from the higher courts as to the correct test for the POEM of the trusts, so that the UT concluded that it was unlikely to obtain further assistance from the unpublished FTT decision.

Comment

It is reassuring to see the UT uphold principles of fairness in deciding whether a party may seek reliance upon an unpublished decision since, as the UT noted, HMRC will generally have far greater awareness of unpublished decisions than the taxpayer or his or her advisers. However, the UT noted that there is no rule of law which prevents a party from relying on an unpublished decision in another tribunal and that each case depends upon its facts. It would be interesting to see how these arguments may play out in a scenario in which there were no (or few) existing authorities, in the context of a particularly novel point of law.

UT's decision to uphold the FTT's penalty under the follower notice regime illustrates HMRC's enforcement powers

In *Kevin John Pitt v HMRC* [2024] UKUT 00021 (TCC), the UT upheld the FTT's analysis of the appellant's penalty appeal under the follower notice regime, reaffirming the regime's broad scope, the importance of conducting a purposive interpretation of tax legislation and providing clarification on the relevance of a factual analysis when applying an earlier ruling to a new set of arrangements.

Background

Chapter 2 of the Finance Act 2014 (Part 4) ("**FA 2014**") introduced the concept of a follower notice. Follower notices are aimed at marketed avoidance schemes. Once HMRC has a ruling in one case to say that the scheme (or a similar scheme) does not work, the aim of using a follower notice is to prevent other participants in schemes from pursuing their own protracted dispute in relation to essentially the same matter. On receiving a follower notice, a taxpayer may choose to concede, taking the necessary "corrective action" before the specified time. In the event that the taxpayer does not concede, it risks paying a substantial additional penalty.

Broadly, the regime works as follows. Where a taxpayer has filed a tax return on the basis that they qualify for a tax advantage as a result of particular arrangements, but where HMRC consider the arrangements do not have that effect in light of a "relevant" judicial ruling, HMRC can issue a follower notice specifying the judicial ruling.

In this case, the appellant entered into arrangements involving the acquisition and disposal of loan notes, categorised as "relevant discounted securities" for the purposes of Schedule 13 of the Finance Act 1996 ("**FA 1996**"). In summary, the intention was to generate a loss by which the appellant could claim relief on his income tax liability for the relevant year.

The appellant transferred assets to two wholly owned companies in return for loan notes in those companies (he had earlier derived those assets by withdrawing funds from director's loan accounts of those companies). He paid £1m for the issue of the loan notes whose principal amount was £1m and which carried a right to interest at 0.5% per annum. The terms of the loan notes were such that their market value was significantly lower. The appellant assigned £750,000 in total in principal amount of the loan notes to connected parties (the Kevin John Pitt Settlement 1999 and the Kevin John Pitt Children's Settlement 1999, together the "Settlements"; the appellant had created these Settlements for the benefit of himself and his family). The market value of the loan notes on the date of transfer to the **Settlements** was agreed to be £55,316. Consequently, the appellant claimed a loss of £694,684 and sought tax relief of £278,557.60 in respect of his income tax liability.

The FTT had noted the "total artificiality of the transactions", namely, that the appellant deliberately subscribed to the loan notes at an over-value and was indifferent to the fact that he was paying substantially more for the loan notes than they were worth, the motivating factors being to benefit his children, make provision for his retirement and prevent accessibility of funds to creditors.

HMRC's follower notice relied upon the case of Audley v HMRC [2011] UKFTT 219 (TC). That case also concerned the provisions of Schedule 13 FA 1996. Briefly, the taxpayer transferred £250,000 cash and his principal residence, valued at £1.8m, to a settlement trust (Trust One) of which he was settlor, trustee and life tenant. Trust One resolved to create and issue the loan note. Shortly afterwards, the loan note was gifted to the trustee of a new settlement established by the taxpayer (Trust Two). The FTT noted the significant discrepancy between the terms of the loan note and normal commercial terms and also that the loan note had no commercial reality. The FTT concluded that the only purpose of issuing the loan note was to generate a loss that would be eligible for income tax relief.

The taxpayer argued that the FTT was wrong in its approach of identifying Audley as a "relevant" judicial ruling for the purposes of the follower notice regime. In particular, he emphasised a distinction between primary facts on the one hand and "reconstituted" facts (reconstituted by the application of Ramsay) on the

other. His argument was essentially that the FTT had erred in failing to restrict its analysis to a straightforward comparison of whether the primary facts in Audley were the same as the primary facts in his case.

He further argued that the follower notice regime was intended to cover situations where the taxpayer persisted in their approach despite it being "blindingly obvious" to them (without the need for tax advice) that they would lose in light of the previous judicial ruling.

Decision

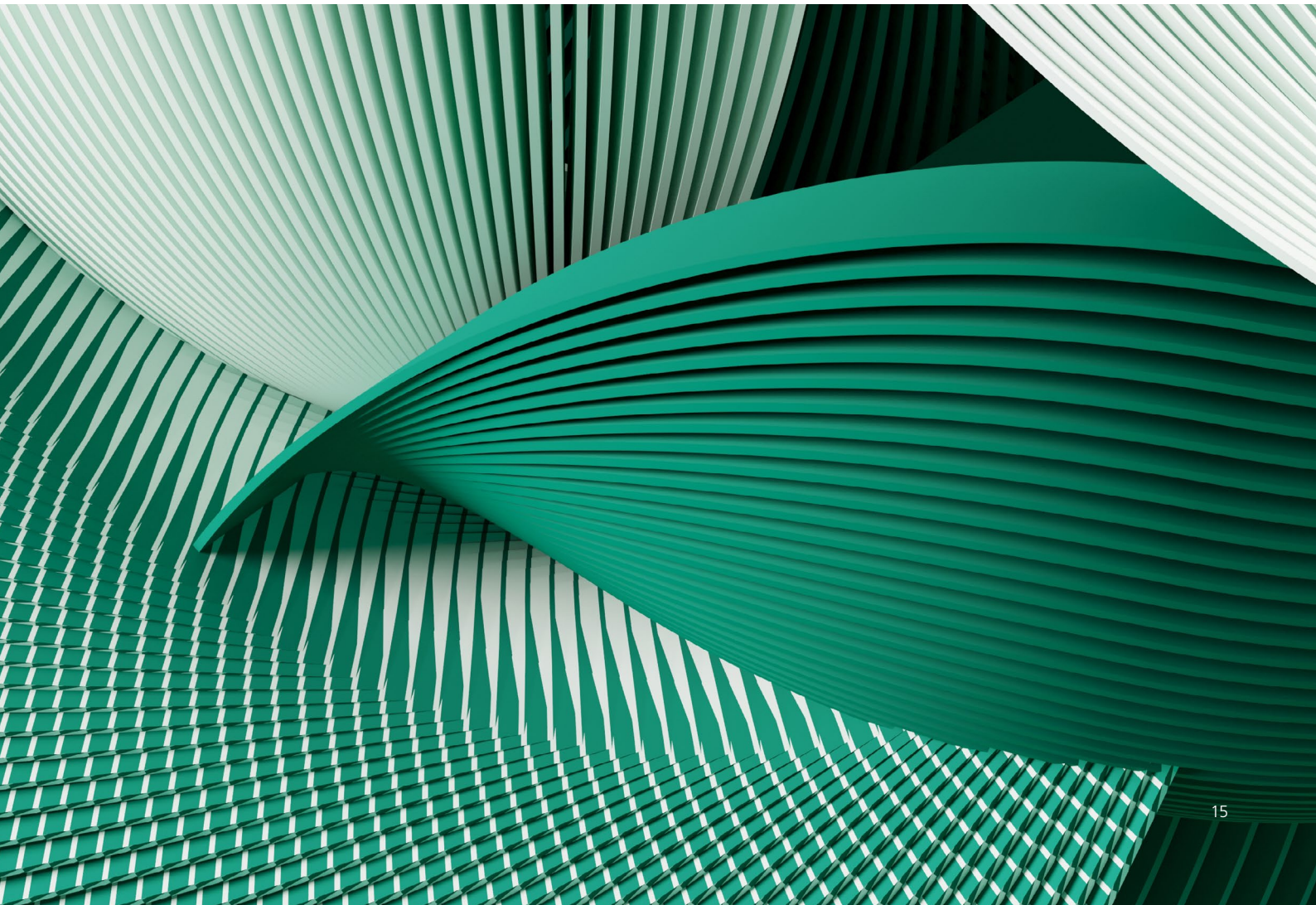
The UT upheld the FTT's judgment, noting that the Court was correct to have regard to post-Ramsay facts, i.e. facts viewed realistically following a purposive interpretation of the relevant legislation. While the UT agreed that the legislation required a factual comparison between the previous judicial ruling and current set of arrangements, such a comparison "follows from the application of the principles and reasoning in the ruling relied on in the follower notice to the facts of the taxpayer's case". The UT criticised the simple "primary fact by fact approach" taken by the appellant, noting that such an approach would mean that the follower notice regime "would have little to bite on" (i.e. it would serve limited purposes beyond identical schemes).

As such, the UT considered the premise of the appellant's grounds of appeal to be flawed. The FTT had not erred in its approach of extracting the principles and reasoning in Audley and then considering what the results would be when those apply to the facts of the appellant in this case.

Comment

The UT's judgment clarifies the determination of "relevant" judicial rulings encompassing not only primary facts but also evaluative facts that are intrinsic to a purposive reading of the relevant legislation. The judgment provides a useful commentary on the importance of applying a Ramsay analysis when deriving the principles and reasoning of previous rulings.

The effect of this determination is the potential widening of the scope of the follower notice regime. It is worth pausing to reflect upon the potential consequence of this for taxpayers. In R (*on the application of Haworth*) v Revenue and Customs Commissioners [2021] UKSC 25 Lady Rose noted that, given the severe consequences of the follower notice regime for a taxpayer (i.e. the regime discourages a taxpayer from pursuing their claim), such statutory powers "must be interpreted as authorising only such degree of intrusion as is reasonably necessary to fulfil the objective of the provision in question".



FTT allows the taxpayer's appeal in relation to entrepreneurs' relief, on the basis that the High Court would have granted rectification

In *Jonathan Cooke v HMRC* [2024] UKFTT 272 (TC), the FTT allowed the taxpayer's appeal in a case involving the availability of entrepreneurs' relief, in which the taxpayer had accidentally, as a result of rounding in a spreadsheet, held only 4.99998% of the ordinary share capital in the Company. In reaching this decision, the tribunal concluded that the High Court would, if asked to consider the matter, grant rectification of the documents, with the effect that entrepreneurs' relief would have been available.

Background

In 2019 the taxpayer disposed of his entire shareholding in ISG Holdings Limited (the "Company") to a third party. At the time of disposal, entrepreneurs' relief was available in respect of a gain if (amongst other conditions) the person making the disposal had held at least 5% of the ordinary share capital for a period of one year prior to disposal. The taxpayer owned only 4.99998% of the ordinary share capital in the Company, one share short of 5%. This arose from a mistake made upon his acquisition of shares in the Company, due to the fact that a spreadsheet had been used to calculate the number of shares in question and it had rounded the percentages to two decimal places. It was clear that he intended to purchase 5% of the ordinary share capital, rather than a fixed number of shares.

The taxpayer argued that if appropriate proceedings were brought in the High Court, the High Court would order the rectification of certain documents in such a way as to secure that during the year preceding the disposal the appellant held at least 5% of the ordinary share capital of the Company. Therefore, the FTT should proceed as if such rectification had been ordered.

Decision

The FTT concluded that the High Court would, if asked, have granted rectification of the documents, with the effect that the conditions for entrepreneurs' relief would have been met. This was on the basis that, "the oral evidence from all parties was that a minimum of 5% was a clear red line for [the taxpayer], due to the fact that he wanted to claim entrepreneurs' relief". The appeal was allowed accordingly.

Comment

The FTT's decision includes an interesting analysis of the law of rectification, a principle which clearly saved the day for this taxpayer. This argument therefore remains a useful tool, in circumstances where commercial intentions were clear, but where an execution error has occurred.

Other developments

VAT provisions relating to EU law

Measures are now in force which govern the interpretation of VAT law in light of Brexit and the Retained EU Law (Revocation and Reform) Act 2023 (the "**REUL Act**"). The Government has always maintained that a "bespoke" approach would be taken to EU-derived VAT law (as opposed to other EU-derived UK law), which would not be fully subject to the REUL Act. Draft legislation was released for consultation last year and has been included in an amended form in the current Finance Bill. The provisions were provided with temporary statutory effect by the passing of the budget resolutions on 27 November 2023.

The provisions purport to provide certainty for taxpayers, by providing that EU-derived UK VAT legislation should be interpreted in line with general principles of EU law. However, certain caveats apply. No UK legislation (primary or subordinate) can be quashed or disapplied by reason of incompatibility with EU law, and the authority of ECJ case law is subject to the same provisions in the REUL Act. This means, for example, greater powers for the Court of Appeal and Supreme Court to depart from pre-31 December 2020 case law. Various recent statements by the Government are clear that its view is that these provisions permit EU principles to apply only as an aid to interpreting UK legislation, and that, where a UK VAT provision conflicts with the EU legislation from which it derives, the UK legislation will prevail.

A consequence of this is that UK taxpayers may, in particular contexts, no longer be able to rely upon the principle of direct effect. This has given rise to a number of points of uncertainty in specific contexts. In their recent brief "Interpretation of VAT and excise law from 1 January 2024" HMRC state they have consulted with specific sectors on such points, and their view is that "where businesses have before been able to rely on direct effect there are no adverse results".

Technical consultation – off-payroll working

In January, HMRC launched a technical consultation on draft regulations setting out the mechanism by which HMRC will be able to account for taxes already paid by individuals and their intermediary on income received from off-payroll working when recovering the tax due under PAYE from the employer. The draft statutory instrument contains the provisions to be introduced in the Income Tax (Pay As You Earn) Regulations 2003 to allow the PAYE liability that is recovered from the deemed employer to be reduced by amounts of tax already assessed and/or paid by the worker and their intermediary. It also specifies the conditions under which it can apply, the mechanics of the recovery and the appeal rights associated with it. The consultation closed for submissions in February and the outcome, and revised draft regulations, are awaited.

Transfer pricing and diverted profits tax statistics

HMRC has published the latest annual update in the series "Transfer Pricing and Diverted Profits Tax Statistics", covering the twelve months to 31 March 2023. The transfer pricing yield – which includes additional tax revenue from transfer pricing enquiries, Advance Pricing Agreements ("**APAs**") and transfer pricing Mutual Agreement Procedure ("**MAP**") cases – was £1.64 bn in 2022 to 2023. 153 transfer pricing enquiry cases, including real-time interventions, were settled in 2022 to 2023, and the average age of a settled enquiry was 38.9 months.

Responses to transfer pricing, permanent establishment and diverted profits tax consultation

H HMRC has published its response to the consultation on transfer pricing, permanent establishment and diverted profits tax ("**DPT**"). A further consultation on draft legislation will tax place during 2024.

Key points from the response are as follows:

— The Government recognises that UK:UK transfer pricing is in some cases imposing an unnecessary compliance burden and has committed to relax the obligation to apply transfer pricing between UK entities in situations where the UK tax base is not disadvantaged. A voluntary opt in to UK:UK transfer pricing will be considered alongside this.

— There is an intention to replace sections 152 to 154 of the Taxation (International and Other Provisions) Act 2010 with a fixed rule which disregards the effect of guarantees (but not implicit support) on the amount of debt, in circumstances where the provision of the relevant guarantee is within the scope of transfer pricing.

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— Whether to adopt the definition of a permanent establishment contained in Article 5 of the 2017 OECD Model Tax Convention ("**MTC**") in UK domestic legislation remains under consideration.

— Discussions are ongoing with stakeholders in the asset management sector, to ensure that any changes do not have unintended consequences for foreign investors in funds which are managed or advised upon in the UK.

— A refresh of the profit attribution legislation has broad support. The Government will hold a technical consultation on draft domestic legislation, which will align with the current version of Article 7 of the 2017 OECD MTC.

— The Government's intention to bring the DPT regime into corporation tax was confirmed.

Update on ongoing investigations in relation to the Corporate Criminal Offence of the failure to prevent the facilitation of tax evasion

— HMRC has published an update on its ongoing investigations in relation to the Corporate Criminal Offence of the failure to prevent the facilitation of tax evasion (the "**CCO**"). As at 1 January 2024, it had 11 live investigations and 24 live 'opportunities' currently under review. These investigations and opportunities span 10 different business sectors including software providers, accountancy and legal services, labour provision and transport.

Call for evidence on deadlines, penalties, safeguards

HMRC has published a call for evidence inviting views on how certain aspects of tax administration could be reformed. In particular, the consultation invites views on HMRC's enquiry and assessment powers, penalties and safeguards. The consultation forms part of the Government's 10-year strategy, first published in July 2020, to build a "trusted, modern tax administration system", which was followed by a number of calls for evidence and responses.

The wide-ranging consultation document raises a large number of issues and potential reform solutions on which respondents are invited to comment. Among the suggestions are:

— aligning HMRC enquiry and/or assessment powers and deadlines for all tax regimes;

— moving towards strict timelines for the opening of enquiries and/or assessments (rather than timelines which can be impacted by reference to HMRC "knowledge");

— a reform of the penalties regime to align late submission, late payment and inaccuracy penalties across all tax regimes, and to remove the focus on penalties linked to current taxpayer behaviour (in causing the loss of tax), and to focus instead on past compliance and current co-operation; and

— increasing the use of alternative dispute resolution, and making statutory reviews mandatory in some circumstances and unavailable in others.

The consultation closes on 9 May 2024.

Pandora Papers – further compliance activity

HMRC's compliance activity in relation to the Pandora Papers (the release of offshore data by the International Consortium of Investigative Journalists, a large proportion of which data related to individuals establishing interests in companies in "low tax" or "secrecy" jurisdictions) continues. HMRC has announced that letters are being issued to individuals which outline key risks specific to their individual domicile positions. The letters inform recipients to report all their overseas income and gains on which they owe UK tax, or face penalties of up to 200% of tax due, or alternatively prosecution.

Update to EU list of non-cooperative jurisdictions

In February, several jurisdictions were removed from the EU list of non-cooperative jurisdictions for tax purposes. Bahamas, Belize, Seychelles and the Turks and Caicos Islands were removed from Annex I of the list (of non-cooperative jurisdictions). An additional two jurisdictions were removed from Annex II, the "state-of-play" document for jurisdictions which do not (yet) comply with the agreed tax good governance standards but have committed to legislative reform: Albania and Hong Kong.

Public Accounts Committee report on HMRC service levels

The Public Accounts Committee has released its most recent report on HMRC performance. The report notes that the overall level of customer service provided by HMRC has deteriorated to such an extent that it has reached an "all time low". It takes aim at the closure of taxpayer support channels, at a time when both the taxpayer population and the complexity of tax affairs are increasing. Additionally, the Committee's view is that HMRC's judgments on where to direct its resources "can appear at odds with the risks it is managing". For example, the report notes that there has been a significant reduction in criminal proceedings which "sends the wrong message". At the same time, HMRC's approach to IR35 is "deterring legitimate activity".

Spring Budget

Developments in the Spring Budget on the business tax front were relatively few, with much of the focus instead being on the taxation of non-domiciled individuals. Key developments on the business tax front included the following:

— It was announced that the intention is to extend full expensing to leased assets when fiscal conditions allow.

— From the tax year 2024/2025 onwards the Economic Crime (Anti-Money Laundering) Levy paid by very large businesses (with revenues exceeding £1 bn) will increase from £250,000 to £500,000 per annum.

— The Government will begin legislating on the new Reserved Investor Fund, an unauthorised contractual scheme, which is intended to create an onshore, flexible, lower-cost alternative to existing fund structures.

— The end date for the Energy Profits Levy will be extended to 31 March 2029.

— A consultation launched relating to a proposal to provide private companies with an intermittent trading venue (known as PISCES). It would incorporate elements from capital markets, such as multilateral trading, and elements from private markets, including a greater discussion on what company disclosures should be made public.

— A new UK Independent Film Tax Credit was announced, for eligible UK-made films with production budgets of up to £15 million.

— The VAT registration threshold will be raised to £90,000.

— Multiple dwellings relief, a relief from SDLT applicable to bulk purchases of residential property, will be abolished.

— A further reduction to employee NICs was announced.

— The higher rate of capital gains tax will be reduced to 24%.

Tax Administration and Maintenance Day

Tax Administration and Maintenance Day took place on 18 April 2024.

The announcements were as follows: (i) consultation published on VAT treatment of private hire vehicles; (ii) announcement that new guidance is to be published on umbrella companies and that consideration is being given to a statutory due diligence requirement for businesses that use umbrella companies; (iii) consultation on introducing a VAT relief for low value goods which businesses donate to charities and which charities give to people in need; and (iv) consultation on draft regulations mandating employers operating in a freeport or investment zone to provide their employees' workplace postcode to HMRC if they are claiming secondary Class 1 NIC relief through payroll.

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.

Selling via online marketplaces as a non-established taxable person (January 2024)
HMRC have issued letters to those whom HMRC suspects may be "non-established taxable persons" ("**NETP**") who are trading in the UK via online marketplaces. The letter informs recipients that HMRC can notify online marketplaces on which the recipient trades about their status as a NETP. This means that the marketplace can begin collecting VAT at the point of sale and paying it to HMRC. The letter contains a reminder that the per annum VAT threshold does not apply to a NETP, so any NETP trading in the UK via online marketplaces must register for VAT regardless of annual turnover. Recipients are only asked to take action if they do have an establishment in the UK. Such recipients are requested to contact HMRC with evidence, the details of which are set out in the letter.

Suspected dividends and distributions (February 2024)
HMRC are writing to taxpayers whom HMRC suspects may have received but not declared dividends on their self-assessment tax returns. The letter states that HMRC has reviewed the accounts for a company in which the recipient is a shareholder, and that such accounts show a sizeable decrease in the profit and loss reserves for a named accounting period. Therefore, HMRC suspects that the shareholders have received a dividend or distribution from that company. The letter contains details of how recipients can disclose and pay underpaid tax (plus interest and penalties) to HMRC, as well as information on how to respond to HMRC should the recipient have no income to declare.

Group annual investment allowance claims (February 2024)
The Wealthy and Mid-sized Business Compliance team has sent letters to taxpayers to clarify the rules surrounding the Annual Investment Allowance ("**AIA**"), and to ensure recipients are aware of their tax obligations. The letter contains an explanation of the restrictions of the AIA, especially in relation to groups of companies, who are only entitled to claim the maximum AIA amount between them. Recipients are requested to check their AIA claims for named accounting periods, and, if they discover a mistake, to amend the relevant return within 30 days of the date of the letter. Recipients are also asked to contact HMRC via a provided email address, if they consider that the information HMRC holds about the group's AIA claims is incorrect.

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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