Tax update

Augut 2017

In this update we report on the Government's intention to use the Finance Bill (No. 2) 2017 to retrospectively implement the policies dropped from the first Finance Act 2017; amendments to the new disguised remuneration provisions in the Income Tax (Earnings and Pensions) Act 2003; and the implementation of the guidance requirement under the Criminal Finances Act 2017. We also comment on three recent cases on when inactivity on the part of HMRC will result in the Tribunal directing HMRC to issue a Closure Notice; the circumstances in which a Member State's national court can review a tax information request made by another Member State; and the circumstances in which valid penalties can be issued by HMRC for non-compliance with an Information Notice.

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Any comments or queries

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About this update

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

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

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Berlioz – ECJ confirms that third parties can challenge "foreseeable relevance" of tax information exchange requests

In *Berlioz Investment Fund SA v Directeur de l'administration des Contributions directes* (Case C-682/15), the Court of Justice of the European Union (ECJ) has confirmed that a Member State's national court can review a tax information request made by another Member State in order to assess whether the requested information is "foreseeably relevant". more›

Anstock – Tribunal quashes penalties imposed for failure to comply with Information Notice

In *Anstock v HMRC* [2017] TC05784, the FTT has confirmed that penalties for failure to comply with an Information Notice issued by HMRC can only be imposed if the Information Notice in question is unambiguous, clear and precise. more›

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News

Second Finance Act delayed until autumn but measures effective from April 2017

On 13 July 2017, the Government published draft Finance Bill (No. 2) 2017. The Bill legislates for all the policies which were dropped from the first Finance Act 2017 due to limited Parliamentary time being available following the announcement that there was to be a general election in June. This includes policies relating to:

- corporate loss relief
- corporate interest restrictions
- the substantial shareholding exemption, and
- deemed domicile rules.

Measures previously scheduled to take effect from a date which preceded the introduction of the second Finance Act 2017 will apply retrospectively from those earlier dates. The non-domicile rules and loss relief reform will take effect from April 2017.

Making Tax Digital has been deferred until 2019, in respect of VAT for certain businesses, and for other taxes until at least 2020.

The Government plans to lay the Bill before Parliament as soon as possible after the summer recess.

Details of the draft legislation can be found here.

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Finance (No. 2) Bill 2017: Part 7A (disguised remuneration) charge on loans outstanding on 5 April 2019

One of the measures dropped from the first Finance Act 2017 was a provision imposing a charge under Part 7A of the Income Tax (Earnings and Pensions) Act 2003 on loans outstanding on 5 April 2019. On 13 July 2017, the Government confirmed that the Finance Bill (No. 2) 2017 will contain a slightly revised provision.

The main change is the addition of a new disregard where a payment of the principal is made on or after 17 March 2016, where that repayment is the subject of a later relevant step taken before either 5 April 2019, or the repayment date of an approved fixed term loan.

Details of the draft legislation can be found here.

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Corporate offence of failure to prevent tax evasion: guidance requirement now in force

Section 47 of the Criminal Finances Act 2017 (effective from 17 July 2017) requires the Chancellor to publish guidance on the procedures that relevant bodies can put in place to prevent persons committing offences under the Act. This is analogous to the requirement under the Bribery Act 2010 to publish guidance on how to prevent bribery. The section also empowers the Chancellor to endorse guidance published by others. This should foster the development of sector-specific guidance to support the general overarching guidance.

The Criminal Finances Act 2017 can be found here.

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Case Reports

Jörg Märtin – Tribunal directs HMRC to close its inquiry into tax avoidance scheme

In *Jörg Märtin v HMRC* [2017] UKFTT 488 (TC), the First-tier Tribunal (FTT) directed HMRC to close its inquiry as it had taken no action in three years.

Background

Jörg Märtin (the taxpayer) claimed loss relief arising out of the activities of Great Marlborough LLP (the partnership). HMRC alleged, that in doing so, the taxpayer had participated in a tax avoidance scheme, similar to that considered by the FTT and the Upper Tribunal in the various *Icebreaker* and *Acornwood* cases.[1]

In February 2014, HMRC purported to open an inquiry into the taxpayer's 2012/13 tax return. HMRC's letter stated the inquiry was opened on a protective basis and while it might later require information from the taxpayer none was required at that time. Later, in July 2016, HMRC opened an inquiry into the taxpayer's 2014/15 tax return on the same basis.

Apart from some letters passing between the parties, no progress was made with either inquiry. Accordingly, on 15 November 2016, the taxpayer made an application to the FTT under section 28A, TMA 1970, for a direction that HMRC close both inquiries.

In response to that application, on 16 January 2017, HMRC opposed the closure of the 2012/13 inquiry and presented the taxpayer with a long list of information and documents which it required from him. As at the date of the hearing of the application, the taxpayer had not provided the requested information and documents.

On 1 March 2017, HMRC wrote to the taxpayer notifying him that it had closed the inquiry into the 2014/15 tax return. It made no amendment to his 2014/15 return. However, the taxpayer did not accept that HMRC had actually closed the 2014/15 inquiry, because HMRC had indicated it might make later amendments following its inquiry into the partnership's 2014/15 tax return.

The taxpayer applied to the FTT for a direction under section 28A, TMA 1970, that HMRC close its inquiries.

The FTT had to determine the following two issues:

- whether the FTT had jurisdiction with respect to the 2014/15 inquiry, and
- whether HMRC had reasonable grounds to keep the 2012/13 inquiry open.

FTT's decision

The taxpayer's application was granted.

With regard to the first issue, the FTT held that HMRC's letter of 1 March 2017 fulfilled the necessary requirements contained in section 28A(1) and (2)(a) TMA 1970. Whilst the letter indicated there might be later amendments, it clearly stated these would be as a result of the inquiry in respect of the partnership. Section 28B(4), TMA 1970, entitles HMRC to amend a partner's return following an inquiry into a partnership tax return. The 2014/15 inquiry was therefore closed and the FTT had no jurisdiction to prevent an amendment being made.

1. [2010] UKFTT 6 (TC); [2010] UKUT 477 (TCC); [2014] UKFTT416 (TC); [2016] UKUT 361 (TCC); and [2017] UKUT 132 (TCC).

With regard to the second issue and the 2012/13 inquiry, the FTT was of the view that the information and documentation requested by HMRC was relevant and not an excessive request. The FTT commented that the taxpayer's failure to provide the information and documentation would ordinarily be sufficient "reasonable grounds" to refuse to issue a direction requiring HMRC to issue a closure notice, even in circumstances where the tax at stake is quantified, as it was here. However, the taxpayer had argued that whilst the information was relevant it was too late for HMRC to request it as nearly three years had elapsed since the inquiry was opened. The critical issue was, therefore, whether HMRC's information request was too late.

HMRC attempted to justify, in its submissions, why its officers had failed to request any information for over three years. However, there was no written or oral evidence before the FTT from any HMRC officer. The FTT concluded that HMRC's three year delay in making the information request was not justified and the closure application was granted.

Comment

The legislation does not provide a time limit by which HMRC is required to conclude an inquiry and it is not uncommon for inquiries to become protracted. A long running inquiry can be commercially disruptive, time consuming and expensive, particularly if HMRC issues a number of information requests during the course of the inquiry. There will, therefore, be occasions when a taxpayer decides that an inquiry has gone on for long enough and wishes to bring it to an end. Increasingly, taxpayers are adopting a more proactive approach and are seeking an appropriate direction from the FTT requiring HMRC to issue a closure notice.

The legislation provides that the FTT "shall" direct that HMRC issues a closure notice within a specified period unless satisfied that there are "reasonable grounds" for not issuing a closure notice. There is therefore a presumption that an application should be granted unless HMRC is able to demonstrate that there are reasonable grounds to refuse it.

Rather surprisingly in the present case, no HMRC officers gave evidence, despite some of them being present at the hearing. In the absence of evidence, the FTT concluded that there were no reasonable grounds for refusing the taxpayer's application.

HMRC clearly considered this an important case as it was represented by leading counsel and three junior counsel. The taxpayer represented himself.

Given the importance HMRC appears to attach to this case, it would not be surprising if it sought to appeal the decision to the Upper Tribunal.

A copy of the decision can be found here.

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Berlioz – ECJ confirms that third parties can challenge "foreseeable relevance" of tax information exchange requests

In *Berlioz Investment Fund SA v Directeur de l'administration des Contributions directes* (Case C-682/15), the Court of Justice of the European Union (ECJ) has confirmed that a Member State's national court can review a tax information request made by another Member State in order to assess whether the requested information is "foreseeably relevant".

Background

Directive 2011/16/EU (the Directive) provides an inter-state regime for the exchange of information under which third parties can be requested to supply information in relation to taxpayers.

The preface to the Directive provides:

"The standard of "foreseeable relevance" is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Member States are not at liberty to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. While Article 20 of this Directive contains procedural requirements, those provisions need to be interpreted liberally in order not to frustrate the effective exchange of information."

Berlioz Investment Fund SA (Berlioz) is the Luxembourg parent of Cofima, a French subsidiary. Cofima was subject to a French tax inquiry in relation to its entitlement to an exemption from French withholding tax in respect of a dividend it had paid to Berlioz.

As part of that inquiry, the French tax authorities sought information from the Luxembourg authorities under the Directive. The Luxembourg authorities in turn ordered Berlioz to provide information. The questions that the Luxembourg authorities raised largely concerned the nature of Berlioz's activities. Berlioz answered most of the questions asked of it but refused to provide certain other financial information on the grounds that the information sought was not "foreseeably relevant" for determining whether Cofima was entitled to the French withholding tax exemption.

Luxembourg law provides for a financial penalty in the case of non-compliance with an information request. A penalty in the sum of €250,000 was imposed on Berlioz for not providing all of the information which had been requested. This was later reduced to €100,000 by the Luxembourg Administrative Tribunal. Berlioz progressed its appeal and a reference was made to the ECJ.

ECJ's judgment

The ECJ largely agreed with the opinion expressed by the Advocate General in this case.

It confirmed that Article 47 of the EU Charter of Fundamental Rights (the Charter), which provides a right to an effective remedy for everyone whose rights are guaranteed by EU law, applied to penalty proceedings.

Although the Charter only applies to Member States when they are implementing EU law, the domestic penalty imposed by Luxembourg could be regarded as doing so because it enabled the requested tax authority to comply with the Directive's obligations. The ECJ therefore concluded that in order to satisfy the requirements of Article 47, the domestic court was required to examine the legality of the information request. That examination was, however, limited to verifying that the information request was not manifestly devoid of any "foreseeable relevance". In order to carry out such an examination, the domestic court required access to the entire information request sent by the French authorities to the Luxembourg authorities. However, given the confidential nature of exchange of information requests, Article 47 did not require the entire information request to be supplied to Berlioz. The ECJ confirmed that it was sufficient for the taxpayer's identity, and the tax purpose for which the information was sought, to be provided to Berlioz.

Comment

Given that the number of inter-state tax information requests is not likely to diminish in the foreseeable future, the ECJ's judgment is important for third parties seeking to ensure that they do not provide confidential information unnecessarily.

The ECJ has confirmed that Article 47 of the Charter entitles a person to challenge the legality of a tax information request received from another Member State. In order to satisfy the requirements of Article 47, the domestic court is required to determine the legality of the information request by verifying that the information requested is not devoid of any foreseeable relevance. A Member State is not permitted to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of the taxpayer concerned.

A copy of the judgment can be found here.

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Anstock – Tribunal quashes penalties imposed for failure to comply with Information Notice

In *Anstock v HMRC* [2017] TC05784, the FTT has confirmed that penalties for failure to comply with an Information Notice issued by HMRC can only be imposed if the Information Notice in question is unambiguous, clear and precise.

Background

HMRC has formidable information powers at its disposal which enable it to compel taxpayers and third parties to provide it with information and documents.

HMRC's main information powers are contained in Schedule 36, Finance Act 2008. A person who fails to comply with an Information Notice issued by HMRC is liable to penalties (both an initial penalty and daily penalties) and such penalties are regularly imposed by HMRC when it considers the recipient of an Information Notice has failed to comply with the request.

In the instant case, HMRC issued an Information Notice to Mr Anstock (the taxpayer) under paragraph 1, Schedule 36, Finance Act 2008 (the Notice), in the context of an inquiry being conducted into his affairs. HMRC formed the view that the Notice had not been complied with and issued penalties to the taxpayer who appealed to the FTT.

FTT's decision

The FTT considered the requirements which must be satisfied in order for such penalties to be valid and lawful and confirmed that:

- the Notice must be properly sent and received (with the onus being on HMRC to demonstrate on a balance of probabilities that this has occurred)
- the Notice must be precise, clear and unambiguous in its requests, and
- only if the above two requirements are satisfied should the FTT decide whether the Information Notice has been materially complied with.

The FTT, in reviewing the evidence (or lack thereof) presented by HMRC, concluded that, on a balance of probabilities, HMRC had failed to satisfy the first requirement. HMRC had produced no evidence to indicate that the notice had been sent and received and on that basis alone the appeal would have been allowed. However, the FTT said that HMRC had not satisfied the second requirement and noted:

"The Notice offends just about every tenet for the proper drafting of a document which is intended to have legal effect ... The Notice is so poorly drafted that it would be perverse to conclude that the recipient of it could know precisely what it was that he was required to provide to the respondents by way of either information or documents."

Comment

The FTT has provided some helpful guidance in relation to the validity of penalties issued by HMRC for non-compliance with Information Notices. Penalties can only be imposed if the Information Notice is unambiguous, clear and precise. Furthermore, the requirements of the Information Notice must be easily discernible from within its "four corners".

Badly drafted Information Notices are not uncommon. Such Notices should be challenged at the earliest opportunity and if HMRC fails to correct inadequacies that are drawn to its attention it will have no one to blame but itself should the taxpayer subsequently successfully appeal to the FTT against penalties imposed for non-compliance with the notice.

A copy of the decision can be found here.

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