Tax update

December 2019

In this month's update we report on (1) two recent decisions concerning insolvent companies and EBTs in the context of insolvency law; (2) proposed legislation on HMRC's use of automated processes; and (3) the taxation of cryptoasset transactions using exchange tokens.

We also comment on three recent cases relating to (1) legitimate expectation; (2) the payment of costs by HMRC due to its unreasonable behaviour; and (3) the meaning of 'deliberate' in the Taxes Acts.

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Any comments or queries?

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About this update

Our Tax update is published on the first Thursday of every month, and is written by members of RPC's Tax 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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First Choice Recruitment – HMRC ordered to pay taxpayer's costs due to its unreasonable behaviour

In *First Choice Recruitment Ltd v HMRC* [2019] UKFTT 412 (TC), the First-tier Tribunal (FTT) has held that the taxpayer was entitled to its costs because HMRC had acted unreasonably. more>

Cliff – Tribunal considers the meaning of 'deliberate'

In *Cliff v HMRC* [2019] UKFTT 564, the FTT has held that the taxpayer 'deliberately' submitted an inaccurate tax return to HMRC. more>

News items

High Court considers EBT arrangements in the context of corporate and insolvency law

In two recent High Court decisions concerning insolvent companies, employee benefit trust (EBT) schemes were considered in the context of corporate and insolvency law.

In *R Toone and another v W Ross and another* [2019] EWHC 2855 (30 October 2019), funds paid into an EBT were found to constitute illegal capital distributions. The Court held that, although payments of a company's capital had been made through an EBT and an interest in possession fund, they had in substance been distributions. Due to a failure to comply with the statutory code, the Court held that they constituted unlawful distributions and were void. Accordingly, a payment of substantial expenses to an employee had been made at a time when the company had been insolvent and in breach of the directors' duty to take into account the interests of creditors.

In *P D Allen and another v A M Bernard and other*s [2019] EWHC 2885 (30 October 2019), implementation was found not to constitute a breach of the director's duties. The Court held that there had been no dishonesty on the director's part, and he had adopted the EBT scheme in good faith on the advice of experts in the belief that it would promote the success of the company.

While both decisions were decided on their own facts, they illustrate the potential, far-reaching ramifications of the use of EBTs and other tax planning arrangements. The decision in *Toone* is particularly surprising, given that HMRC had assessed the payment into the EBT as a payment of earnings, subject to income tax (following the decision of the Supreme Court in *RFC 2012 plc (in liquidation) (formerly Rangers Football Club Plc) v Advocate General for Scotland* [2017] 1 WLR 2767). It is hard to see, therefore, how the same payment can be both a payment of income, and a distribution of capital to shareholders.

The *Toone* decision can be viewed here.

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Proposed legislation on HMRC automated processes

On 31 October 2019, HMRC published a technical note on proposed legislation which will apply both retrospectively and prospectively to perfect HMRC's use of automated processes to serve certain statutory notices and carry out specified "routine" tasks.

The legislation will provide that, in relation to the specified tasks, anything capable of being done by an HMRC officer may, instead, be done by HMRC through the use of a computer or other electronic means. The tasks that will be covered include providing individuals, trustees, partnerships and corporate bodies with notices to file returns, correcting personal or trustee returns and penalty determinations.

HMRC considers that this will not result in a change for taxpayers. It has been introduced, it says, due to recent case law in which it has been held, in certain circumstances, that automated

notices do not satisfy the relevant legislation. HMRC has confirmed that the legislation will not be applied retrospectively to taxpayers who received a settled judgment from a court or tribunal on the issue of automation before 31 October 2019. It provides no such clarity, however, for taxpayers who have ongoing litigation involving such issues.

The technical note can be viewed here.

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Policy paper on the taxation of cryptoasset transactions by companies and other businesses

On 1 November 2019, HMRC published a policy paper on the taxation of transactions undertaken by companies and other businesses using cryptoasset exchange tokens, such as bitcoin.

For the purpose of filing tax returns, the calculation of taxable profits will be undertaken in pounds sterling. For transactions which do not have a pound sterling value, the appropriate exchange rate at the time must be used in order to convert the value to pounds sterling in order to file tax returns.

To determine the correct tax treatment, the question of whether the transaction involving exchange tokens constitutes a trade is a key factor. Factors to be considered include the degree and frequency of activity, the level of organisation and intention of the parties. Mining activities may be regarded as trading. If exchange tokens are held as investments, any gain arising on their disposal will be a chargeable gain (unless, in the context of corporation tax (CT), the non-trading activity is charged to CT under the intangible fixed asset or, rarely, the loan relationship rules).

HMRC does not regard cryptoassets as currency, money or, because there is typically no counterparty standing behind the token, debt. Therefore, CT legislation that applies to currency, money or debt does not apply to cryptoassets. However, the loan relationship rules would apply to ordinary loans backed by exchange tokens as security.

The policy paper provides guidance on how transactions of exchange tokens are to be treated in respect of CT, Chargeable Gains Tax, VAT, Income Tax, National Insurance and Stamp Duty Land Tax (SDLT). It also confirms HMRC's view that the transfer of exchange tokens would not be subject to stamp duty (SD) or Stamp Duty Reserve Tax (SDRT) because exchange tokens are unlikely to meet the definition of stock or marketable securities and that tokens given in consideration for stock or marketable securities or land would be considered money's worth for SDRT and SDLT purposes. For SD purposes, cryptoassets do not constitute money, stock or marketable securities, but could constitute chargeable consideration in the form of debt.

The policy paper can be viewed here.

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Case reports

Aozora GMAC Investment – HMRC did not breach a taxpayer's legitimate expectation

In *R (oao Aozora GMAC Investment Ltd) v HMRC* [2019] EWCA Civ 1643, the Court of Appeal has dismissed the taxpayer's claim that a statement in HMRC's International Manual created a legitimate expectation, because the taxpayer had not relied on it substantively and, even if it had done so, there was insufficient "unfairness" in frustrating the taxpayer's expectation.

This report is based on an article which was first published in Tax Journal on 5 November 2019. A copy of that article can be viewed here.

Background

A UK resident subject to UK tax on income or gains attracting foreign tax may claim unilateral relief from double taxation. At the relevant time, this was achieved through a claim under section 790, Income and Corporation Taxes Act 1988 (ICTA). Section 793A(3), ICTA, restricted the availability of relief under section 790 if a double tax treaty contained an express provision to the effect that relief by way of credit was not to be given in particular cases or circumstances specified or described in the treaty.

Aozora GMAC Investment Ltd (the Claimant) received interest payments on loans it had made to its US subsidiary. The US imposed withholding tax on the interest. HMRC issued closure notices, which had the effect of preventing the Claimant from using the withheld tax to offset its UK corporation tax liability on the interest payments.

According to HMRC, the double tax provisions contained in section 793A operated to prevent relief under section 790. The UK and the US had entered into a double tax treaty (the Treaty), Article 23 of the Treaty provided that UK resident companies could only benefit from double tax relief if they were "qualified persons". Article 24(4)(c) restricted the circumstances in which a qualified person could claim relief by way of credit against UK corporation tax.

The section of HMRC's International Manual (the Manual) dealing with section 790 stated that the only provision to which section 793A applied was Article 24(4)(c) of the Treaty. This statement was subsequently removed as it was inaccurate.

The Claimant claimed that the Manual contained a representation that the scope of section 793A was limited to precluding the availability of credit relief only in one particular circumstance, which was not applicable in its case. According to the Claimant, that representation gave rise to a legitimate expectation that it would be taxed in accordance with that interpretation of section 793A, irrespective of whether the Manual was accurate as a matter of law.

Dismissing the judicial review claim, the High Court held that the Claimant had not relied on the representation when deciding to arrange the loans to the US subsidiary and it was not unjust for HMRC to resile from the representation in the Manual. The Claimant appealed to the Court of Appeal.

Legitimate expectation

The general principles relating to legitimate expectation were summarised by Lord Neuberger in *United Policyholders Group v Attorney General of Trinidad and Tobago* [2016] 1 WLR 3383, PC, at [37]-[39]. In summary, the principle of legitimate expectation is based on the proposition that, where a public body states that it will do (or not do) something, a person who has reasonably relied on the statement should, in the absence of good reasons, be entitled to rely on the statement and act accordingly. The principle is, however, subject to important limitations.

In *R v IRC ex p MFK Underwriting Agencies Ltd* [1990] 1 WLR 1545, Bingham LJ made the following observations at 1569B:

"I am, however, of opinion that in assessing the meaning, weight and effect reasonably to be given to statements of the revenue the factual context, including the position of the revenue itself, is all important. Every ordinarily sophisticated taxpayer knows that the revenue is a tax-collecting agency, not a tax-imposing authority. The taxpayer's only legitimate expectation is, prima facie, that he will be taxed according to statute, not concession or a wrong view of the law ... Such taxpayers would appreciate, if they could not so pithily express, the truth of the aphorism of "One should be taxed by law, and not be untaxed by concession": *Vestey v Inland Revenue Commissioners* [1979] Ch. 177, 197 per Walton J. No doubt a statement formally published by the Inland Revenue to the world might safely be regarded as binding, subject to its terms, in any case falling clearly within them".

Bingham LJ went on to state that where a representation had been made to a particular taxpayer following a request for a ruling, it is necessary that the ruling statement relied on should be "clear, unambiguous and devoid of relevant qualification". In *R (oao Davies) v HMRC*; *R (oao Gaines Cooper) v HMRC* [2011] UKSC 47, where the issue was whether taxpayers who had moved abroad could claim non-resident tax status on the basis of certain paragraphs in a published Revenue booklet, Lord Wilson confirmed that Bingham LJ's requirement that representations should be "clear, unambiguous and devoid of relevant qualification" applied also to representations made in guidance formally published by HMRC to the world. Further, it is clear from the judgment in *Davies* that the content of the alleged representations is to be determined on an objective basis.

The role of HMRC's guidance

The UK tax code is one of the most complicated in the world. A conversation on the subject barely goes by without lip service being paid to the fact that "simplifying" the tax code should be a priority. We even have an Office for Tax Simplification, designed for this very purpose. HMRC's guidance is therefore an essential component in the process of understanding and applying the tax code. As the Court of Appeal itself observed in this case, HMRC publishes manuals to assist its own staff to understand and apply the law. HMRC's guidance is regularly referred to in correspondence by HMRC officers as if it represented the law, and is held up as forming the basis of their decisions and/or exercise of their discretion.

The High Court in this case observed that the representation in the Manual was clear, unambiguous and devoid of any relevant qualification, to the effect that the ordinarily sophisticated taxpayer was not required to look beyond Article 24(4)(c) of the Treaty when considering the potential disapplication of unilateral relief pursuant to section 793A(3). The Court of Appeal agreed with the High Court and held that an ordinarily sophisticated taxpayer would not have realised that he needed to read the statement in the Manual as dealing only with express Treaty provisions that apply to qualified persons.

HMRC argued in this case that the terms of the Manual identify only an expression of HMRC's views as to the construction of the relevant provision. The mere expression of a view as to the interpretation of a statutory provision cannot, it said, amount to a "representation" to taxpayers generally giving rise to a substantive legitimate expectation worthy of protection by the courts. HMRC framed this argument on the basis that an ordinarily sophisticated taxpayer would be aware of the critical distinction between the role of Parliament to make the law and the role of HMRC to administer the collection of taxes. This limited role means, so HMRC claimed, that it is not reasonable for taxpayers to rely on HMRC's interpretation of the law.

The Court gave short shrift to this argument. It said at [31]:

"I do not accept the contention that because the ordinarily sophisticated taxpayer knows that HMRC apply the law but do not make the law, there can never be a legitimate expectation arising from a statement by HMRC in published guidance as to what the law is …

… some statements issued by HMRC … go beyond a mere expression of its opinion as to the law. For example, a taxing statute may contain wording which is inherently uncertain, such as where it describes something as needing to be "substantial" or "material" or states that something must be done within a "reasonable time". HMRC will wish to ensure that all members of staff apply the term in the same way so that taxpayers are dealt with consistently, regardless of which officer handles their case. That guidance may then be published so that taxpayers can conduct their affairs on the basis of the bright line created by HMRC's practice. In other cases, the legislation may by its terms confer a discretion on HMRC in the exercise of some power without spelling out the criteria to be applied. Again, in order to ensure consistent treatment, HMRC may issue guidance setting out what factors staff should take into account and may publish that guidance so that taxpayers know the kind of information that will be relevant to the decision that they are inviting HMRC to make."

Application

Having established that, construed objectively, a statement made by HMRC was capable of giving rise to a legally enforceable legitimate expectation, the Court then turned to the question of whether the statement had done so in the particular circumstances of the instant case, and concluded (in agreement with the High Court) that it did.

As to whether or not it was "fair" for HMRC to resile from its guidance, as contained in the Manual, the Court cited the dicta from the Court of Appeal in *R (Hely-Hutchinson) v HMRC* [2017] EWCA Civ 1075, where Arden LJ said at [45]-[46]:

"If HMRC finds that they need to resile from guidance, a taxpayer can only rely on the legitimate expectation that the guidance created where, having regard to the legitimate expectation, it would be so unfair as to amount to an abuse of power."

The question, therefore, is seemingly whether or not there has been sufficient unfairness to prevent correction of the mistake by HMRC. The authorities make clear that the unfairness has to reach a very high level; it has to be "conspicuously unfair".

However, the Supreme Court in *R (on the application of Gallaher Group Ltd) v Competition and Markets Authority* [2018] UKSC 25 recently stated at [31]:

"Fairness, like equal treatment, can readily be seen as a fundamental principle of democratic

society; but not necessarily one directly translatable into a justiciable rule of law. Addition of the word "conspicuous" does not obviously improve the precision of the concept. Legal rights and remedies are not usually defined by reference to the visibility of the misconduct".

Notwithstanding the decision in *Ex p Unilever plc* [1996] STC 681, the Supreme Court in *Gallaher* held that "conspicuous unfairness" was not a free-standing ground of review. The "unfairness" claimed must, however, be so pronounced as to be "irrational".

The Court in the present case held that, irrespective of the decision in *Gallaher*, there was a need for a high degree of unfairness to be established by the taxpayer, given that the primary duty of HMRC is to collect tax. It said at [49]:

"Lord Carnwath in Gallaher was not dispensing with the need for a high degree of unfairness to be established before the court would prevent HMRC resiling from a representation, assurance or promise. I consider that wherever an express representation is established it is still essential for the court to consider all the factors relevant to whether it would be unfair to allow HMRC to frustrate an expectation arising from that promise, assurance or representation and further that a high level of unfairness is necessary to override the public interest in the collection of taxes to which I have referred."

Detrimental reliance

The question the Court was asked to consider was whether the absence of any evidence as to why the statement was being resiled from required the Court to conclude that permitting HMRC to do so would be unfair (it is noteworthy that the Court did not deal with the concept of irrationality and preferred the language of "abuse of power" and "high degrees of unfairness").

In *R (oao Vacation Rentals (UK) Ltd) v HMRC* [2018] UKUT 383 (TTC), the Upper Tribunal rejected HMRC's contention that the claimant needed to show conspicuous unfairness and said at [89]:

"In our view it is only open to HMRC to override the legitimate expectation that it has encouraged in circumstances where there is a sufficient public interest to override it ...".

HMRC's position in this appeal was that it was not for HMRC to show why it has resiled from the guidance, on the contrary, it was for the taxpayer to establish how it had relied on the Manual to its detriment, and to make good the "high degree of unfairness" complained of.

The Court agreed with HMRC that detrimental reliance was relevant and indeed an important factor in cases such as the present where the issue involves HMRC's wish to resile from guidance. It also held that the burden does not shift to HMRC to adduce evidence to the court showing some public interest in it being able to resile from the representation.

In applying this reasoning, the Court stated that the High Court was correct to consider first the issue of how influential the Manual was in the Claimant's decision-making process. It said that there were two aspects to this: first, the extent to which the Claimant knew about the guidance and was influenced by it when arriving at a view on the tax position and, secondly, the extent to which its view on the tax position influenced the decision to use the Claimant for its US investment. The Court said at [53]:

"If a taxpayer is unaware of the existence of guidance or if, as in *Hely-Hutchinson*, he only becomes aware of it after he is committed to the transaction giving rise to the tax dispute, then that may well prove fatal to his claim".

The Court disagreed with the High Court, which held that "degrees of reliance" were necessary to consider when conducting its evaluative exercise. It also disagreed with the High Court on the issue of whether it mattered that the taxpayer's advisor relied on the guidance, as opposed to the taxpayer itself. The Court stated that the fact that the taxpayer's advisor, as opposed to the taxpayer, relied on the guidance did not affect the position. Ultimately, however, the Court implied that it would be fact-specific. Even tax specialists, fluent in the law, may advise their clients that, in light of certain published guidance, a particular interpretation of a provision is likely to be accepted by HMRC (irrespective of what the abstract technical positon may appear to be).

The Court concluded that reliance on the representation made in the Manual was weak because (i) the representation was merely as to HMRC's opinion about the construction of a relatively straightforward legal provision; and (ii) specialist advice was sought on the meaning of the legislation and how it would apply to its particular circumstances. It also commented that the Claimant could not point towards sufficient reliance on the Manual that led it to suffer some form of detriment. The Claimant argued that the higher rate of tax being incurred was sufficient to establish detriment. In the view of the Court, there was no evidence before it which set out how the structure would have been affected differently had the threat of an additional tax liability been material to that decision.

Comment

It is of some concern that in this case HMRC sought to relegate the role of its own guidance, and argue that it is unreasonable for taxpayers to rely on HMRC's publicly stated position of the law. For some taxpayers who have access to appropriate professional advice, this may not be an issue but for the vast body of taxpayers who have little understanding of tax law, HMRC's guidance is of vital importance to how they conduct their tax affairs. Likewise, as the Court pointed out, in circumstances where a statute contains an inherent degree of uncertainty, understanding HMRC's views on its construction is essential, even for professional advisors.

Fortunately, the Court confirmed that, in publishing guidance, HMRC is exercising a managerial discretion as the publication of guidance is an important aspect to the way in which HMRC manages the collection of taxes. As the Court noted at [32]: "Guidance as to the meaning of the taxing statutes also facilitates the self-assessment process by helping taxpayers and their advisers complete their self-assessment forms correctly". The Court drew attention to Bingham LJ's comments in the *MFK* case (cited above), that statements formally published by HMRC to the world might safely be regarded as binding, subject to their terms, in any case falling clearly within them.

The Court focused extensively in this case on the taxpayer's reliance on HMRC's guidance. In *R (GSTS Pathology LLP & Ors) v HMRC* [2013] EWHC 1801 (Admin), Leggatt J stated, in summarising the law on legitimate expectation, that:

"Although it has sometimes been said to be a requirement also that the claimant has relied to its detriment on what the public authority has said, the law now seems to be clear that such detrimental reliance is not essential but is relevant to the question of whether it would be an unjust exercise of power for the authority to frustrate the claimant's expectation ...".

The Court of Appeal in this case has perhaps elevated the need to establish detrimental reliance to the level of "essential", although it noted that in most cases that should not be an issue as decisions to, for example, effect transactions, are often only made after the taxpayer has considered and relied on HMRC guidance.

The Court returned to the idea of matters having to be so unfair as to amount to an "abuse of power", which is perhaps surprising given that, in *Gallaher*, the Supreme Court recently stated that "Such language adds nothing to the ordinary principles of judicial review, notably in the present context irrationality and legitimate expectation". Whilst *Gallaher* reaffirms the principle that substantive unfairness is not a free standing ground for judicial review, in the context of a claim under breach of legitimate expectation, it will nevertheless be essential to evidence a high degree of unfairness in order to make good a case that it is not lawful for the public body to resile from its promise.

In order to establish a claim for breach of legitimate expectation, a taxpayer must be able to point to clear guidance from HMRC or, even better, a written ruling, and make good in evidence that they relied on that guidance/ruling, which caused them to suffer some form of detriment and to a high degree. It is perhaps regrettable that the Court of Appeal poured cold water on the point made by the Upper Tribunal in *Vacation Rentals*, that HMRC should be required to justify its frustration of a taxpayer's legitimate expectation, once it has been established. Should this matter proceed to the Supreme Court, that point may be revisited.

The judgment can be viewed here.

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First Choice Recruitment – HMRC ordered to pay taxpayer's costs due to its unreasonable behaviour

In *First Choice Recruitment Ltd v HMRC* [2019] UKFTT 412 (TC), the First-tier Tribunal (FTT) has held that the taxpayer was entitled to its costs because HMRC had acted unreasonably.

Background

HMRC refused to direct that First Choice Recruitment Ltd (First Choice) was not liable to pay deductions under the Construction Industry Scheme. First Choice appealed to the FTT.

The issues to be determined on appeal were whether:

1. First Choice had taken reasonable care to verify the "gross payment status" of a subcontractor, and
2. First Choice's incorrect view that the subcontractor in question had "gross payment status", had been reached in good faith.

HMRC's statement of case included allegations of fraud, made on the basis of emails passing between the directors of First Choice. These emails were not produced in evidence by HMRC. In fact, the only emails that were included in its evidence demonstrated that First Choice was not aware that the relevant subcontractor did not have gross payment status.

First Choice argued in its skeleton argument that:

- the allegations of fraud had shifted the burden of proof onto HMRC
- HMRC's pleadings and particulars were inadequate in relation to the allegations of fraud, and
- HMRC's evidence was insufficient to discharge the burden of proof.

The appeal hearing had been listed to be heard on 20 August 2018. On 16 August 2018, HMRC wrote to the FTT withdrawing from the appeal.

First Choice made an application to the FTT for its costs under Rule 10(1)(b) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Tribunal Rules) on the grounds that HMRC had acted unreasonably in defending and conducting the proceedings.

FTT decision

The application was granted.

The FTT found that HMRC had acted unreasonably in defending and conducting the appeal and ordered HMRC to pay First Choice's costs relating to both the appeal and the costs application.

In the FTT's view, HMRC's allegations of fraud, and the lack of particularisation of those allegations by referring to emails which were not produced in evidence, were "egregious". The FTT also considered that it was unacceptable for a public authority to make allegations of fraud where there was no credible evidence to support such allegations.

HMRC had admitted that an "appropriately qualified and experienced" caseworker would not have made the allegations of fraud. In the view of the FTT, this admission was not an acceptable excuse, and commented that HMRC should have a system of supervision and training in place to ensure that litigators deal with matters appropriately and to the requisite standard. The FTT also considered that if HMRC's Solicitor's Office had handled the case in the same way, that would potentially have amounted to serious professional misconduct.

The FTT found it "particularly worrying" that HMRC had submitted that its conduct in the case was reasonable, as this suggested that HMRC may continue to make similar unsupported allegations of fraud in the future.

Comment

As taxpayers are only too well aware, the FTT has in the past been reluctant to award costs against HMRC. However, HMRC's unreasonable behaviour in this case was so gross that the FTT had little choice other than to order HMRC to pay the taxpayer's costs. If taxpayers consider that HMRC has acted unreasonably in "bringing, defending or conducting the proceedings", they should consider making an application to the FTT, under rule 10(1)(b) of the Tribunal Rules, for an order that HMRC pay their costs.

This case also highlights a worrying lack of supervision within HMRC. An allegation of fraud is a serious matter and should not be made lightly. It would appear that in this case an inappropriately qualified caseworker was allowed to make serious allegations of fraud against a taxpayer who was forced to take its appeal to the FTT only for HMRC to withdraw from the appeal four days before the appeal was due to be heard. Such conduct was rightly censured by the FTT, but such a situation should not have been allowed to arise in the first place. HMRC must train its officers to an appropriate standard and there must be proper supervision by line managers, particularly when their actions can have such a detrimental impact on a taxpayer's business and/or life.

The decision can be viewed here.

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Cliff – Tribunal considers the meaning of 'deliberate'

In *Cliff v HMRC* [2019] UKFTT 564, the FTT has held that the taxpayer 'deliberately' submitted an inaccurate tax return to HMRC.

This report is based on an article which was first published in Tax Journal on 18 October 2019. A copy of that article can be viewed here.

Background

Mr Cliff was a tax consultant who also considered himself to be self-employed as a 'dealer in thoroughbreds'. He purchased shares in racehorses, or in horse racing partnerships. Over a five-year period, Mr Cliff lost £160,000 and accordingly claimed loss relief. The relevant tax years were 2009/10, 2010/11 and 2011/12.

In June 2017, HMRC issued assessments, under section 29, Taxes Management Act 1970 (TMA), disallowing Mr Cliff's loss claims (the discovery assessments) and in July 2017 it assessed Mr Cliff to penalties under paragraph 1, Schedule 24, Finance Act 2007 (FA 2007) (the penalty assessments).

The relevant legislation

Under section 29, TMA, a discovery assessment can only be issued if one of two conditions are fulfilled:

1. the loss of tax was brought about 'carelessly or deliberately' by the taxpayer (or someone acting on his behalf), or
2. the relevant officer of HMRC could not have been reasonably expected to be aware of the loss of the tax at the time when they ceased to be entitled to give notice of an enquiry.

HMRC relied only on the first condition, and its primary case was that the loss of tax had been brought about deliberately.

Under paragraph 1, Schedule 24, FA 2007, HMRC can issue penalties for inaccuracies in a return which has led to an understatement of tax, but only if the inaccuracy was careless or deliberate. Deliberate inaccuracies carry higher penalties than careless inaccuracies.

HMRC sought penalties from Mr Cliff on the basis that his inaccuracies were deliberate.

The key question was whether Mr Cliff could be said to have acted deliberately if he had no intention to deceive.

Mr Cliff appealed the discovery assessments and the penalty assessments to the FTT.

FTT decision

The appeals were dismissed.

The FTT first considered whether the description 'dealer in thoroughbreds' was an accurate description of Mr Cliff's activities. It determined that it was not, because he did not buy or sell horses, but rather shares in horses. Furthermore, he was not a 'dealer', because he did not, at least in respect of the partnerships, expect or intend to make a profit, and he took no part in training the horses or in deciding when they should be sold.

The FTT then considered whether the inaccuracy was deliberate.

Mr Cliff argued that the inaccuracy was not deliberate because there was no conscious decision to act deceitfully, or with illicit intentions. HMRC's case was that any considered choice, knowingly made, was deliberate.

The FTT accepted HMRC's view, stating at paragraph 23:

"We conclude, in agreement with the Respondents, that 'deliberate' means a conscious choice to act in a certain way … We also agree that this choice does not have to be accompanied by an intention not to pay tax or be made without good faith, as a loss of tax can be brought about by a taxpayer making a purposeful but poor decision".

The FTT gave only one normative reason for this conclusion. It said, at paragraph 29, that if 'deliberate' required an intention to deceive, then "it would be difficult to see what meaning should attach to 'fraudulent'". The FTT applied this meaning of deliberate both to the discovery assessments and the penalty assessments.

Implications of the decision

If this decision is correct, it potentially has a number of serious consequences for taxpayers:

- the time limit for discovery assessments will be greatly extended in many cases, as the limit is 20 years where a deliberate loss of tax is involved, rather than four years (in the ordinary case) or six years (in cases of carelessness) (see sections 34 and 36, TMA)
- this consequently extends the time limits for issuing penalties, as a penalty assessment can be made up to 12 months after the discovery assessment is issued (or, if the assessment is appealed, 12 months after the end of the appeal process) (see paragraph 13(3), Schedule 24, FA 2007)
- the penalties for inaccuracies will be significantly higher, as a deliberate inaccuracy carries a penalty of up to 100% of the potential lost revenue (for domestic matters) or 200% (for offshore matters) (see paragraph 4, Schedule 24, FA 2007)
- HMRC cannot suspend Schedule 24 penalties if it has levied the penalties on the basis of deliberate behaviour (see paragraph 14, Schedule 24, FA 2007)
- the taxpayer is placed in HMRC's 'managing serious defaulters' regime and the taxpayer's details may be published (see section 94, FA 2009).

Fundamentally, the FTT's reasoning appears to erode the behavioural distinction between careless and deliberate behaviour. Further, if deliberate conduct requires only a conscious action and an inaccuracy, taxpayers filing returns on the basis of a *bona fide* but ultimately incorrect interpretation of the law will find themselves subject to a 20-year discovery period and, potentially, higher penalties. This is plainly not the policy intention behind the behaviour-based regimes. In our view, this erosion cannot be justified either on policy grounds, or as a matter of statutory interpretation.

Unanswered questions

The FTT's reasoning leaves several questions unanswered.

The word "fraudulent" is no longer used in the legislation. Accordingly, it is difficult to understand why it should matter that Mr Cliff's interpretation of 'deliberate' leaves no room for a different meaning for 'fraudulent'. Must a special meaning also be given to 'carelessness',

as otherwise there would be no room left for 'negligence'? In any event, is 'deliberate' not the modern word for 'fraudulent'? Section 36, TMA, was (until 1 April 2010) headed 'fraudulent or negligent conduct'.

In fact, does the context not compel the conclusion that 'deliberate' does mean fraudulent: the most draconian penalties should be reserved for fraudulent behaviour in order to incentivise honest and conscientious tax returns. In the context of the Schedule 24 penalty provisions, the term 'deliberate' has usually been interpreted by the tax tribunals as requiring blameworthy or dishonest conduct, in contrast with the purely mechanical error in the return that was present in *HMRC v Tooth* [2019] EWCA Civ 826. For example, in *Auxilium Project Management v HMRC* [2016] UKFTT 249 (TC), the FTT said (at paragraph 63): "A deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely on it as an accurate document".

HMRC's official publications and procedures recognise that an allegation of deliberate conduct is an allegation of fraud. HMRC's Code of Practice 9 guidance is headed 'investigations where we suspect tax fraud' and goes on to say: "Under the investigation of fraud procedure, the recipient of COP9 is given the opportunity to make a complete and accurate disclosure of all their deliberate and non-deliberate conduct ... The term 'deliberate conduct' means that the recipient knew that an entry or entries included in a tax return and/or accounts were wrong, but the recipient submitted it/them anyway, or that the recipient knew that a liability to tax existed but chose not to tell HMRC at the right time".

'Carelessness' is defined in the legislation as 'a failure to take reasonable care' (paragraph 3(1), Schedule 24, FA 2007 and section 118(5), TMA). But the meaning attached by the FTT to 'deliberate' is in fact a lower standard than carelessness, because all it requires is that the taxpayer made a conscious decision to use the inaccurate words. Accordingly, a taxpayer might take all proper care (including by instructing a professional adviser) and have acted deliberately but not carelessly.

As the FTT noted in *Leach v HMRC* [2019] UKFTT 352 (TC), the explanatory notes to Schedule 24 refer repeatedly to the level of penalty being based on 'behaviours', with the most serious penalties being reserved for "deliberate and concealed behaviours". The notes say that the concepts set out in the schedule provide "a uniform language for behaviours", and that "where a person has taken reasonable care in completing their return ... no penalty will arise". The FTT's decision in that case was that this behaviour-based approach shows that the meaning of 'deliberate' cannot extend to purely mechanical errors, where there is no intention to mislead.

The FTT's decision in *Cliff*, however, leads to the perverse result that a taxpayer is better off stating that he completed his tax return without properly considering his answers, so that he can be said to have acted carelessly rather than deliberately.

The FTT also relied on the *obiter* comments of the Court of Appeal in *Tooth* on the meaning of 'deliberate'. The decision in *Tooth* is itself concerning for taxpayers, but it does not support the reasoning in *Cliff*. That is because, in *Tooth*, the taxpayer knew that he was filling out his return incorrectly, and the issue was the extent to which this could be cured by clarifying the situation elsewhere on the return. That was not the case in *Cliff*.

Different meanings of "deliberate" for different provisions?

In *Cliff*, the FTT applied the same meaning of 'deliberate' both to discovery assessments and the penalty assessments. However, in *Leach*, the FTT applied different meanings of deliberate to (a) penalties under Schedule 24, and (b) assessments under section 77(4A), Value Added Tax Act 1994.

The FTT's view in *Leach* was that a Schedule 24 deliberate penalty required the taxpayer to knowingly provide an inaccurate document, with the intention that HMRC should rely on it as an inaccurate document. That effectively means that there must be an intention to mislead. In our view, this must be correct. Tax penalties, unlike provisions extending time (eg in the context of discovery cases), are 'criminal' for the purposes of Article 6 of the European Convention on Human Rights (see *Euro Wines (C&C) Ltd v HMRC* [2012] UKUT 0359 (TCC)). Schedule 24 contains no 'reasonable excuse' defence and, as the FTT in Leach observed, had Parliament intended that penalties should be charged under Schedule 24 for purely mechanical errors (such as those in *Tooth*), where there was no intention to mislead, a similar 'reasonable excuse' defence would have been necessary to avoid injustice.

Comment
If this decision is correct, and HMRC is acting lawfully in issuing deliberate penalties in circumstances where there is no blameworthy conduct attributable to the taxpayer, it could undermine the vital safeguards previously thought available to taxpayers taking "reasonable care".

The purpose of penalty provisions is to penalise and discourage certain types of behaviour. Whether a taxpayer deliberately intends to mislead HMRC, or is merely careless, is therefore critical to determining what level of penalty (if any) should be applied.

Fundamentally, a taxpayer acting with care, for example, on professional advice, and taking a *bona fide* and considered view of the law should not be subjected to penalties for deliberate behaviour, or at all. The issue with the decision in *Tooth* is that the meaning of the word "deliberate" may be context specific as between penalty and discovery cases. Whilst this form of inconsistency is undesirable, it is perhaps the inevitable effect of the Court of Appeal's *obiter* comments in *Tooth*. It is in any event to be hoped that a higher court will review the reasoning of the FTT in this case and clarify the position further.

The decision can be viewed here.

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