Tax update

February 2019

In this month's update we report on (1) an Economic Affairs Committee report on treating taxpayers fairly; (2) HMRC's extension of the deadline for responses to its consultation on the taxation of trusts; and (3) the Law Society's practice note on the offence of failure to prevent the criminal facilitation of tax evasion. We also comment on three recent decisions relating to (1) the principles governing disclosure in the context of tax appeals; (2) business property relief under the Inheritance Tax Act 1984; and (3) the closure of an HMRC enquiry which was "drifting aimlessly".

News items

Report of House of Lords Economic Affairs Committee – The Powers of HMRC: Treating Taxpayers Fairly

On 4 December 2018, the House of Lords Economic Affairs Committee published a report in which it concludes that recent powers provided to HMRC, including the use of accelerated payment notices (APNs), undermine the rule of law and are driving people towards bankruptcy by unfairly targeting freelance workers. more›

HMRC extends its deadline for responses to its consultation on the taxation of trusts

On 7 November 2018, HMRC began a consultation into the taxation of trusts. The consultation was originally due to last 12 weeks but the consultation period has been extended to 28 February 2019. more›

Law Society publishes updated practice note on the Criminal Finances Act 2017

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Case reports

Addo – Disclosure against HMRC in tax appeals

In *Addo v HMRC* [2018] UKFTT 530 (TC), the First-tier Tribunal (FTT) considered the principles governing disclosure in the context of appeals before the FTT. more›

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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The Estate of Maureen Vigne – Livery business qualified for BPR for IHT purposes

In *HMRC v Personal Representatives of the Estate of Maureen M Vigne* [2018] UKUT 357 (TCC), the UT, in dismissing HMRC's appeal, has confirmed that a livery business attracted business property relief (BPR) under section 105, Inheritance Tax Act 1984 (IHTA), as the business did not consist of wholly or mainly in making or holding investments. **more›**

Patel – HMRC ordered to close enquiry which was "drifting aimlessly"

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News items

Report of House of Lords Economic Affairs Committee – The Powers of HMRC: Treating Taxpayers Fairly

On 4 December 2018, the House of Lords Economic Affairs Committee published a report in which it concludes that recent powers provided to HMRC, including the use of accelerated payment notices (APNs), undermine the rule of law and are driving people towards bankruptcy by unfairly targeting freelance workers. The Committee calls for the law to be changed to include the right to appeal against an APN. It also suggests that the government should consider widening the role of HMRC's Adjudicator or increasing HMRC obligations to respond to and act on Adjudicator recommendations.

Since publication of the report, the government has committed to conducting a review of the April 2019 Loan Charge, which will affect a large number of taxpayers who have certain loans which are outstanding on 5 April 2019. There are growing concerns over the impact of the Loan Charge on taxpayers and their families. It remains to be seen whether the review will lead to any change in the law.

A copy of the report can be viewed here.

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HMRC extends its deadline for responses to its consultation on the taxation of trusts

On 7 November 2018, HMRC began a consultation into the taxation of trusts. The consultation was originally due to last 12 weeks but the consultation period has been extended to 28 February 2019.

The government has not made any specific proposals for reform of the taxation of trusts but, not surprisingly, discourages the use of non-resident trusts for tax avoidance purposes. Amongst the options discussed in the consultation document is the possibility of targeted reform to the inheritance tax regime as it applies to trusts.

A copy of the consultation document can be viewed here.

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Law Society publishes updated practice note on the Criminal Finances Act 2017

On 4 January 2019, the Law Society published an updated practice note that provides guidance to solicitors on the corporate offence of failure to prevent the criminal facilitation of criminal tax evasion, which came into force on 30 September 2017.

The practice note is intended to assist solicitors understand this complex area of the law, assessing their risks, and implementing relevant and appropriate compliance measures. It recognises that the Criminal Finances Act 2017 brings a risk of criminal liability to solicitors' firms, not just for their employees' actions, but for the actions of others with whom they are associated. The note makes it clear that the offence is not about tax law, it is about fraudulent behaviours and indicators which are dishonest and the prevention of such behaviours.

A copy of the practice note can be viewed here.

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Case reports

Addo – Disclosure against HMRC in tax appeals

In *Addo v HMRC* [2018] UKFTT 530 (TC), the First-tier Tribunal (FTT) considered the principles governing disclosure in the context of appeals before the FTT.

The report below is based on an article which was first published in Tax Journal on 22 November 2018.

RPC acted for the successful taxpayer in this case.

Background

The substantive appeal in *Addo v HMRC* [2018] UKFTT 530, relates to discovery assessments issued by HMRC to Ms Addo (the taxpayer) under section 29, Taxes Management Act 1970 (TMA), for the tax years 2009/10 and 2010/11. For the purposes of this report, details of the arrangements under challenge by HMRC are not relevant.

The taxpayer's grounds of appeal included whether the discovery assessments were validly issued and in particular:

- whether a "discovery" within the meaning of section 29(1) was made in her case, and
- whether the conditions in sections 29(5) were met (it being accepted by HMRC that the taxpayer's return was not careless or deliberately incorrect, within the terms of section 29(4)).

The burden of proof on the validity of a discovery assessment issued under section 29 falls on HMRC. The FTT had previously directed, following an earlier hearing, that HMRC should open its case first at the substantive appeal hearing (*Janet Addo v HMRC* [2018] UK FTT 0093 (TC)).

Witness statements in the substantive appeal were served by HMRC and included a witness statement from Andrew John Finch, an officer of HMRC who led HMRC's investigation. Mr Finch's statement referred to various relevant documents or categories of documents, which included:

- consultations between "specialist Investigations" teams and "specialist transfer of assets abroad" (ToAA) team
- consultations with the ToAA team
- a report from an "independent review panel"
- a "handling strategy" following the independent review panel report, and
- documents relating to discussions between investigators and "discovery specialists".

The taxpayer wrote to HMRC requesting a copy of the above documents. In a letter in response, HMRC indicated that the documents were "protected documents" and declined to provide a copy of the requested documents. HMRC did not claim privilege or public interest immunity in relation to the documents, rather, it considered that the documents were "confidential and sensitive".

Given HMRC's refusal to supply the taxpayer with a copy of the requested documents, the taxpayer made an application to the FTT for a direction that HMRC provide her with a copy of the above documents.

The taxpayer argued that she was entitled to disclosure of the requested documents under rule 27(2)(b) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules, SI 2009/273 (the Tribunal Rules), as they were documents on which HMRC was "intending to rely" in the proceedings. The documents were all referred to directly or indirectly in Mr Finch's witness statement which was expressed to be in support of HMRC's case for assessment under section 29. If the taxpayer did not have access to the material, she would not be in a position to test HMRC's evidence and the FTT would not be in a position to determine whether or not Mr Finch's description of the documents, or his understanding of them, was correct.

It was also argued that if the taxpayer was not entitled to disclosure under rule 27(2)(b), the FTT should exercise its discretion to direct or order disclosure of the material under rules 5(3) or 16 of the Tribunal Rules. When deciding how to exercise its discretion to direct disclosure in accordance with the "overriding objective" to deal with cases fairly and justly (rule 2(1), Tribunal Rules), the FTT must bear in mind the key principle of whether or not the document in question is relevant to the proceedings (*HMRC v Ingenious Games LLP and others* [2014] UKUT 0062 (TCC)).

HMRC's position was that:

- it did not "rely" on the documents requested
- the documents were not relevant to the taxpayer's appeal, and
- it would be generally disproportionate to order disclosure of the documents as they are, amongst other things, highly sensitive and may prejudice HMRC's position in relation to other taxpayers.

FTT decision

The FTT observed that the obligation in respect of disclosure on parties in tax appeals before it is more limited than that in ordinary litigation before the courts, which requires "standard disclosure" by the parties. Rule 31 of the Civil Procedure Rules (CPR) specifically requires disclosure of documents which adversely affect a party's own case and/or support the other party's case. There is also an automatic right to inspect a document which a party has directly referred to in, for example, a witness statement (rule 31.14, CPR). In tax appeals, the parties are only obliged to disclose documents which they intend to rely on (rule 27, Tribunal Rules).

The FTT does, however, have a discretion to order, under rule 16 and/or rule 5(3)(d), Tribunal Rules, a party to produce a document to the FTT and/or another party.

Referring to the decision of the Upper Tribunal (UT) in *Ingenious Games*, the FTT noted that the "guiding principle" for the FTT in exercising its powers to direct the disclosure of documents is to ask what is required to enable it to deal with the case "fairly and justly", in accordance with the overriding objective contained in rule 2(1), Tribunal Rules. The FTT indicated that it should ordinarily be regarded as fair and just for a party to be entitled to review documents held by the other party, or to which the other party has access, which are relevant to the issues to be determined in the case, even if they are not documents on which the other party itself intends to rely (in other words, where the documents are not within rule 27) and even if they are detrimental to the other party's case.

Such a view is supported by rule 31.14, CPR. Although not referred to in the FTT's decision,

HMRC v BPP [2017] UKSC 55, confirmed that the FTT should generally follow the approach adopted in the CPR, even where those rules do not formally apply to proceedings before it. The FTT said at paragraph 65:

"Furthermore, in my view, it must ordinarily be fair and just for a party to be entitled to review documents that are referred to in the other party's pleaded case or in witness statements served by that other party in support of its case. As I have mentioned, this is a requirement of CPR rule 31.14, and, whilst I accept that the CPRs are not directly applicable in proceedings before the Tribunal, that rule simply reflects the fact that basic fairness requires that the parties are placed on an equal footing as regards their opportunities to review the evidence and to test it before the Tribunal."

Rule 2(2) provides that the overriding objective of the Tribunal Rules is "to enable the tribunal to deal with cases fairly and justly". Dealing with cases fairly and justly includes 'dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and resources of the parties' (rule 2(2)(a)). The application of the overriding objective therefore encompasses a concept of proportionality. It will invariably be appropriate to consider whether a direction for disclosure is proportionate when taking into account other factors, such as the nature and importance of the proceedings, the burden imposed upon the disclosing party, and the likely relevance of the documents, or information requested to the issues in the case.

HMRC argued that the documents sought by the taxpayer related to HMRC's view of the arrangements under challenge at "policy" level and that the FTT should not order disclosure of the documents sought as HMRC considered them to be sensitive and confidential in nature. The FTT did not agree with HMRC that a document's 'sensitivity' should amount to a bar on disclosure and said at paragraph 82:

"... my concern with the general proposition is that 'sensitivity' might easily become a cloak to disguise an unwillingness to disclose documents that are unhelpful to a party's case. That is not a good reason for non-disclosure. For that reason, I do not accept the general proposition that the alleged sensitivity of the documents – falling short of circumstances in which a claim for public interest immunity could be made or in which disclosure may result in a breach of confidence – is itself a particular factor that I should take into account."

The FTT also considered whether the "relevant officer" for the purposes of section 29(1), was Mr Finch (if he was not the relevant officer, then documents which he referred to in his witness statement may not be relevant to the taxpayer's case on discovery) and whether the documents sought were relevant for the purposes of section 29(6). It concluded that Mr Finch was a relevant officer, as he was part of discussions concerning the raising of the discovery assessments (even if he himself did not raise them) and that the documents sought were relevant for the purposes of section 29(6), as they speak to what a "hypothetical officer" could reasonably be expected to have known.

The FTT therefore allowed the taxpayer's application and directed HMRC to disclose:

- copies of notes of consultations between specialist investigations teams and the specialist ToAA team
- copies of notes of discussions within the anti-avoidance group
- a copy of the independent review panel report referred to in Mr Finch's statement
- a copy of the handling strategy referred to in Mr Finch's statement, and
- copies of notes of a discussion held concerning the ToAA team.

Comment
This decision provides helpful and much needed confirmation of when HMRC, which is notoriously reluctant to provide disclosure of internal documents, will be required to disclose documents to a taxpayer.

The FTT confirmed that it will take a broad approach when determining the appropriate level of disclosure and that the requirement contained in rule 27, Tribunal Rules, is not the end of the matter. The parties can look beyond rule 27 and seek disclosure of documents that are relevant to the case, even if the party from whom disclosure is sought does not intend to rely upon the documents requested although, ultimately, the FTT will decide whether it would be proportionate, in all the circumstances, to order disclosure.

The FTT also confirmed that it must ordinarily be fair and just for a party to be entitled to review documents that are referred to in the other party's pleaded case, or in witness statements served by that other party in support of its case.

The taxpayer was able to obtain disclosure of the documents sought because the FTT was satisfied that the documents would shed light on HMRC's knowledge and understanding of the arrangements in question, which was highly relevant to the discovery issue. The fact that some of the documents may relate to HMRC's thinking at a higher policy level, rather than specifically to the taxpayer, was not determinative of the issue.

The FTT must treat both parties fairly and HMRC does not have a preferred status before the FTT. HMRC cannot resist making appropriate disclosure simply because it is a public body charged with administering the tax system. The FTT disagreed with HMRC that it should not disclose documents to the taxpayer solely because they were considered by HMRC to be "sensitive" documents. If the FTT had agreed with HMRC, it may have enabled HMRC to use "sensitivity" as a cloak to disguise an unwillingness to disclose documents that are simply unhelpful to its case. The FTT was alert to this danger.

HMRC's application to the FTT for permission to appeal the decision was refused but the UT has granted HMRC permission to appeal to the UT.

A copy of the decision can be viewed here.

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The Estate of Maureen Vigne – Livery business qualified for BPR for IHT purposes

In *HMRC v Personal Representatives of the Estate of Maureen M Vigne* [2018] UKUT 357 (TCC), the UT has confirmed that a livery business attracted business property relief (BPR) under section 105, Inheritance Tax Act 1984 (IHTA), as the business did not consist of wholly or mainly in making or holding investments.

Background

At the time of her death, Ms Vigne (the deceased) owned 30 acres of land on which she operated a "DIY" livery business involving the provision of stables and fields for horses, with the owners undertaking their day-to-day care. She also provided a number of additional services, including worming treatments and the provision of hay in the winter months.

The profits from the business were modest. After the deceased's death on 29 May 2012, HMRC refused her executors' claim for BPR under section 105, IHTA, on the basis that the business consisted "wholly or mainly of ... making or holding investments", within the meaning of section 105(3) and accordingly was not eligible for BPR.

The executors appealed to the FTT, which allowed their appeal and held that the deceased had been operating a genuine livery business. The FTT rejected HMRC's contention that the business consisted wholly or mainly of making or holding investments.

HMRC appealed to the UT.

UT decision

The appeal was dismissed.

HMRC relied on a number of grounds, including:

1. no tribunal, acting judicially and properly instructed as to the relevant law, could have come to the conclusion that the deceased's business qualified for BPR
2. the FTT had incorrectly applied the principles derived from *IRC v George* [2003] EWCA Civ 1763 and *McCall v HMRC* [2009] NICA 12, and
3. had the FTT followed *HMRC v Pawson* [2013] UKUT 50, it would have concluded that the investment predominated.

Ground 1

The UT first addressed the question of its jurisdiction. Section 11, Tribunals, Courts and Enforcement Act 2007, provides for a right of appeal on questions of law only. Findings of primary fact by the FTT could be overturned by the UT only if the FTT had made a finding for which there was little or insufficient evidence. This emanates from a long-standing principle, first established in *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14.

In applying that principle in the instant appeal, the UT said that in deciding whether the business consisted wholly or mainly in making or holding investments, the FTT was simply conducting a multi-factorial assessment on the basis of the primary facts it had found. Since none of the relevant primary facts had been disputed by HMRC, the UT could only overturn the FTT's decision if satisfied that it had applied the wrong legal test, or had plainly misapplied the correct legal test to the facts found. In the view of the UT, the FTT had applied the correct legal test and its conclusion was one it was entitled to reach.

Ground 2
The UT noted that in parts of the FTT's decision, it failed to refer to the "wholly or mainly" requirement in section 105(3) when stating the statutory test. However, on reading the decision as a whole, it was clear that the FTT had had that requirement firmly in mind and had explicitly addressed the point in its final conclusion that the business provided a level of valuable services to the horse owners which precluded a determination that the business was mainly one of holding investments.

Ground 3
HMRC sought to draw a number of parallels with *Pawson*, in which a claim for BPR on a holiday let failed before the UT on the ground that the services provided in connection with letting the property were not sufficient to make the business more than the holding of an investment.

HMRC's criticisms of the FTT's decision were based either on the presumption that the business was essentially one at the "investment" end of the spectrum, or amounted to an assertion that the FTT had placed inappropriate weight on the factors it had identified when assessing whether the business was wholly or mainly one of making or holding investments. The UT concluded that there was not enough in those criticisms to justify any interference with the FTT's conclusion. There was no clear line between businesses which qualified for BPR and those which did not. The FTT had applied the correct legal test and had reached a conclusion it was entitled to reach on the evidence before it.

In the view of the UT, it was overstating the position to argue that any business involving the exploitation of land should, as a matter of law, be assumed to be wholly or mainly a business of investment, unless the taxpayer could establish otherwise.

Comment
This case underlines the difficulty that parties will face when seeking to challenge primary findings of fact on appeal. The UT will only overturn findings of fact where there has been a material and manifest error of law in the FTT's analysis and/or application of principle. The UT did not agree with HMRC that the FTT had erred in law and therefore refused to interfere with the FTT's findings.

A copy of the decision can be viewed here.

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Patel – HMRC ordered to close enquiry which was "drifting aimlessly"

In *Patel v HMRC* [2018] UKFTT 0561 (TC), the FTT directed HMRC to close its enquiry.

Background
Mr Patel (the taxpayer) is a chartered accountant who incorporated his practice to become Ashley King Ltd (the company). The company was charged a fee under a licence agreement for the use of the practice name, business contacts and web domains, the goodwill of which the taxpayer claimed was a personal asset.

The licence fee received under the licence agreement was declared on the taxpayer's self-assessment tax return as income. HMRC opened an enquiry into the taxpayer's 2014/15 tax return in late 2016, in relation to the licence fee and goodwill. The taxpayer provided HMRC with a copy of the licence agreement which explained the nature of the relationship and the payment terms.

HMRC suspected that the licensing arrangement was intended to avoid employer NICs and the matter was referred to various specialist teams within HMRC for advice over the course of the next 12 months.

At no point did HMRC seek to enquire into the tax return of the company, despite HMRC considering that there could be charges to PAYE and employer NICs as a result of the licence fee arrangement.

The taxpayer made an official complaint, claiming that HMRC was ignoring the information he had provided and his technical arguments. He also informed HMRC that he would seek a direction from the FTT requiring HMRC to close its enquiry. HMRC sought further information from the taxpayer and some 21 months after the enquiry had been opened, issued an information notice to the taxpayer pursuant to paragraph 1, Schedule 36, Finance Act 2008.

The taxpayer considered that he had provided all relevant documents and information to HMRC and applied to the FTT for a direction requiring HMRC to issue a closure notice pursuant to section 28A, TMA.

FTT decision
The application was allowed.

HMRC argued that it had not concluded its enquiry in relation to the licensing of the goodwill. Its initial view was that the goodwill could not be personal, in which case the taxpayer would have no goodwill to licence. It was possible that the licence fee payments received from the company should be recharacterised as salary and it therefore required further information from the taxpayer in order to form a definitive view.

HMRC agreed at the hearing that the specialist teams from whom advice had been sought had not been provided with the full facts of the matter and when questioned by the judge, the HMRC enquiring officer confirmed that there was no investigation in respect of the company and that if Class 1 NICs were payable, it was the company, not the taxpayer, which would be liable to pay them. Additionally, if the licence fee payments were salary, then the company would be liable under the PAYE system and as such no amendments would be required to the taxpayer's return.

The FTT referred to *Estate 4 Ltd v HMRC* [2011] UKFTT 269 (TC) and concluded that HMRC's admission that no amendments could be made to the taxpayer's return settled the matter in his favour. There was no tax at risk since Class 1 NICs cannot be recovered from an employee. Additionally, it was not sensible for the enquiry to be kept open when there was no possibility of an enquiry into the company.

The FTT therefore directed HMRC to issue a closure notice in respect of its enquiry into the taxpayer's tax return.

Comment
HMRC does not appear to have conducted its enquiry into the taxpayer's return in a timely and efficient manner. In the words of the FTT, the enquiry "drifted along aimlessly". Sadly, such aimless drifting is only too common in many HMRC enquiries.

HMRC seems to have been influenced in this case by its suspicion that the licence arrangements were designed to avoid NICs and this no doubt contributed to HMRC ignoring the taxpayer's technical arguments and dragging the enquiry out in the hope of finally finding some evidence to support its suspicions.

Increasingly, taxpayers are applying to the FTT for a direction requiring HMRC to close its enquiry within a specified period of time. This latest decision confirms how effective such an application can be and how willing the FTT is, in appropriate cases, to issue such a direction.

A copy of the decision can be viewed here.

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