RPC

Tax update

March 2016

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In *R (on the application of City Shoes Wholesale Ltd) v Revenue & Customs Commissioners* [2016] EWHC 107 (Admin), the High Court rejected an application for judicial review of HMRC's refusal to grant the nine claimants, all of whom had operated employee benefit trusts (EBTs), the full benefits of the Liechtenstein disclosure facility (LDF). more›

Any comments or queries?

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News

DOTAS: New regulations on hallmarks

The government has introduced new regulations to alter the standardised tax products and loss schemes hallmarks relevant to the disclosure of tax avoidance schemes (DOTAS) provisions. The regulations also insert a new financial products hallmark.

The new regulations came into force on 23 February 2016 and further guidance on the revisions to DOTAS are expected in due course.

The regulations are available to view here.

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Direct recovery of debts: restrictions on administrative charges

New regulations have been enacted to limit the charges deposit-takers are able to charge debtors under the direct recovery of debts regime. The regulations mirror the draft proposals and limit the amount a deposit-taker can charge to a maximum of £55.

The regulations are available to view here.

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EU introduces corporate tax avoidance package

The European Commission has produced a detailed paper setting out a raft of new anti-avoidance proposals for the EU in relation to corporate taxation.

The proposals include new Directives which set out minimum anti-avoidance measures to be set into domestic law by member states and reporting obligations. There are also recommendations for the drafting of double tax treaties. The paper forms part of a wider initiative by the EU to deal with corporate tax avoidance across the EU.

The EU Commission's paper is available to view here.

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Cases

Tribunal grants "disclosure" application against HMRC

The recent case of *Tower Bridge GP Ltd v HMRC* [2016] UKFTT 054 (TC) concerned applications by Tower Bridge GP Limited (Tower Bridge) and HMRC to the First-tier Tribunal (FTT) for disclosure of information and documents from each other, pursuant to Rule 5 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Tribunal Rules). Tower Bridge sought disclosure of material principally concerned with policy advice provided to HMRC officers and HMRC sought disclosure of material it considered relevant to the underlying dispute. The FTT ordered that both Tower Bridge and HMRC should provide some disclosure to each other in line with its decision.

Background

Tower Bridge is the representative member of a VAT group that includes CantorCO2e Ltd (CO2e). The underlying substantive appeal relates to decisions made by HMRC on 6 December 2012 to refuse Tower Bridge the right to recover input tax incurred on certain purchases of emissions allowances under the European Union Emissions Trading Scheme (carbon credits) and to issue VAT assessments accordingly. One of the grounds relied upon by HMRC was that CO2e knew, or ought to have known, that the transactions in question were connected with fraudulent evasion of VAT (applying the decision of the ECJ in *Axel Kittel v Belgium Case* C-430/04) (the Kittel issue).

So far as relevant to the applications, there were three underlying issues, namely:

- the validity of certain invoices
- a time limit issue relating to whether HMRC was in time to make an assessment and
- the Kittel issue.

Tower Bridge applied for disclosure of eight categories of documents and information from HMRC. The basis of the application was that the documents requested would enable it to determine whether HMRC had exercised reasonable discretion, in time, and within the statutory framework.

HMRC requested disclosure of internal documents from Tower Bridge.

Rule 5 of the Tribunal Rules sets out the FTT's case management powers. Specifically, Rule 5(3)(d) provides that the FTT may direct:

"... a party or another person to provide documents, information or submissions to the Tribunal or another party."

When exercising any power under the Tribunal Rules (including the power under Rule 5(3)(d)) the FTT must take into account the "overriding objective" set out in Rule 5(1) of the Tribunal Rules to deal with cases "fairly and justly".

The FTT's decision

Whilst acknowledging that the FTT operates a more flexible approach than the courts, Tower Bridge referred the FTT to Rule 31 of the Civil Procedure Rules (CPR) which governs disclosure in the courts. It was submitted that Tower Bridge's application should be treated as analogous to an application for "specific disclosure", under which the court makes an order for the disclosure of specific documents or classes of documents, which are relevant to an issue in the appeal. Although the FTT considered the analysis of CPR 31 useful, the FTT said that it preferred to follow the default position set out in Rule 27(2) of the Tribunal Rules, namely, that each party will disclose to the other only those documents on which it proposes to rely.

However, given the complexity of the issues in the underlying appeal and the serious allegation that a major financial institution either knew, or should have known, that transactions with which it was involved were connected with fraud, the FTT was of the view that there should in this case be a presumption that both parties will disclose relevant material to each other. The FTT said that the test of relevance should not set an unduly high bar. Documents and information that might advance or hinder a party's case, or which might lead to a "train of inquiry" that might advance or hinder a party's case are in principle relevant.

The FTT considered the specific documents requested by each party and whether they should be disclosed. It concluded that HMRC should disclose to Tower Bridge policy advice that the relevant HMRC officer admitted considering when making his decision. The FTT held that the test for "self-certification" for the relevance of documents was appropriate in the circumstances. Should any issues arise in relation to relevance, Tower Bridge would be able to make a further application to the FTT.

In relation to HMRC's application for disclosure, Tower Bridge argued that HMRC had ample opportunity to utilise its Schedule 36 information powers during its enquiries to gather all relevant documentation and information and that it was now seeking to carry out an exercise which should have been performed during the enquiry stage of the process.

The FTT concluded that in the circumstances the documents requested satisfied the relevance test and the fact that HMRC had not utilised its Schedule 36 powers during the course of its enquiries to obtain the documents was not a bar to it requesting disclosure under Rule 5 of the Tribunal Rules (*HMRC v Ingenious Games LLP and others* [2014] UKUT 0062 (TCC) applied).

Comment

This decision provides helpful guidance on the approach to be taken when applying to the FTT for a disclosure direction under Rule 5 of the Tribunal Rules. Given HMRC's traditional reticence about disclosing documentation and information to taxpayers during the course of litigation, taxpayers should not hesitate in applying to the FTT for an appropriate disclosure direction should they form the view that HMRC is in possession of relevant material which it is refusing to disclose.

The decision also confirms that once HMRC's enquiries are concluded and an appeal has been made to the FTT, HMRC cannot utilise its Schedule 36 information powers. If it requires further documents or information from the taxpayer, it must make an appropriate application to the FTT for a disclosure direction.

The decision is available to view here.

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Tribunal confirms that taxpayer was carrying on a trade on a commercial basis

In *Akhtar Ali v HMRC* [2016] UKFTT 8 (TC), the FTT, in allowing the taxpayer's appeal, has provided some helpful guidance on the factors to be taken into consideration when deciding whether activities comprise a trade which is commercial, for the purposes of section 66, Income Tax Act 2007 (ITA).

Background

Mr Ali, the taxpayer, was a pharmacist who ran a successful pharmaceutical business. Since the 1990s he had been buying and selling publicly listed shares, in addition to his pharmacy business. However, from 2005, he decided to become a "day trader" and bought and sold shares on a commercial basis with a view to a profit. He employed locums at the pharmacy in order to free up his time to enable him to engage in share trading. He spent most of his time trading in an upstairs office in the same building as his pharmacy.

In the period 2006 to 2013, the taxpayer continued his share activities, despite making overall losses each year. Notwithstanding these losses, he believed his skills were improving and that he would begin to generate profits from his share trading activities. The taxpayer funded his share trading business from the profits generated from his pharmaceutical business. This enabled him to sustain the losses incurred from his share trading in the relevant years in question.

For tax years up to 2004/05, the taxpayer's returns dealt with the profits or losses from his share activities under the capital gains tax rules. However, from 2005/06 onwards he treated his share activities as a separate trade, and losses were claimed in that and succeeding years.

The taxpayer considered that his share activities comprised the carrying on of a trade and that the trade was commercial under section 66, ITA. He argued that his share activities satisfied the "badges of trade" due to the high frequency of his transactions in short periods and the amount of time and effort he expended in gaining knowledge and experience of trading. Accordingly, the losses stemming from the share activities could be set against the profits of the pharmacy business.

HMRC disallowed the losses generated by the share activities in the period 2006 to 2013, on the basis that the share activities were no more than speculative investment over a prolonged period and should not therefore be treated as trading. HMRC imposed "inaccuracy" penalties at a rate of 10%, under section 8, Taxes Management Act 1970, on the basis that the taxpayer had been negligent and failed to take reasonable care to ensure his returns were correct.

The taxpayer appealed to the FTT.

The FTT's decision

The taxpayer's appeal was allowed.

The FTT's starting point was that the taxpayer's activities bore the classic hallmarks of "trading". Over an extended period of time, he bought assets, in the form of shares (his stock), with the intention of selling them on at a profit. This was further supported by applying the "badges of trade" (as referred to in the report of the Royal Commission on the Taxation of Profits and Income (Cmd 9474)). In the view of the FTT, four of the badges: the length of period of ownership, the frequency or number of similar transactions by the same person, the circumstances that were responsible for the realisation, and motive, pointed firmly in favour of trading. Although the other two badges: subject matter of the realisation and the supplementary work on, or in connection with the property realised, pointed in the other direction, on balance, the FTT concluded that the taxpayer's share dealing activities constituted trading.

The FTT noted that the courts are wary of awarding "trading" status to an individual speculating in shares, as the activity can look like trading, but yet not constitute a trade because it really consists of gambling transactions. In the present case, it was evident that the taxpayer was not gambling, as his activities were not impelled by addiction or habit. In reaching this conclusion, the FTT considered a number of factors, including the following:

Organisation
Although the activities were carried out on an "informal" basis, the FTT considered that external physical equipment required for such activity is minimal, particularly in the age of the internet. A trader needs to "organise his efforts" (as discussed by Rowlatt J in *Graham v Green* [1925] 9 TC 309). The FTT concluded that the taxpayer did have a sufficient degree of internal organisation.

Lack of formal qualifications and the division of time between different activities
With regard to the taxpayer's share activities, the FTT observed that he was operating in a field that did not require any professional qualification, where relevant information was readily accessible. In the light of this, it considered that the taxpayer could (and did) amass sufficient knowledge and ability, through his experience and research, to develop a business plan. The FTT commented that it is not uncommon for self-made business entrepreneurs to be "self-taught" and confident of their abilities.

Funding
The taxpayer was self-funded. The fact that he was able to fund his share activities himself was an indicator that the activity may be non-trading, however, in the FTT's view, activities which constitute trading will be so, whether those activities are funded by third parties or self-funded.

In the light of the above, the FTT concluded that the taxpayer's activities did not constitute gambling transactions and that he was carrying on a trade in undertaking his share activities in the tax years in question.

The next question for the FTT to consider was whether the trade was commercial for the purposes of section 66 ITA. HMRC's position was that given the long time period over which losses had been sustained, the taxpayer's share activities were not carried out on a commercial basis. Applying the guidance provided by Walker J in *Wannell v Rothwell* [1996] 68 TC 719, the FTT concluded that whilst the taxpayer's business plan was unsophisticated, it was nonetheless commercial. Transactions took place at market prices and a business plan was implemented. The fact the taxpayer was self-taught and undertook considerable risk did not cause his trade to be uncommercial as these are indicia of the risk-taking entrepreneur, rather than uncommercial activity. In addition, the trade was carried on with a view to making profit. The fact the taxpayer was willing to persevere through year after year of incurring losses confirmed that he continued to believe his profit-making strategy would prove successful. In the light of this, the FTT concluded that both limbs of section 66(2) ITA were satisfied and his trade was commercial for the purposes of section 66 ITA for each of the tax years in question.

Comment
The courts tend to be wary of awarding trading status to individuals speculating in shares or gambling transactions. The decisive factor in this case appears to have been the FTT's finding that the taxpayer had a business plan (unsophisticated as it was) and had pursued it in a sufficiently organised manner to rebut the presumption that individuals engaging in share

speculation are not trading. Had there been no business plan, or had such a plan not been followed, the taxpayer's appeal may not have succeeded.

The decision is available to view here.

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High Court dismisses judicial review challenge to HMRC's decision to restrict the availability of the Liechtenstein disclosure facility

In *R (on the application of City Shoes Wholesale Ltd) v Revenue & Customs Commissioners* [2016] EWHC 107 (Admin), the High Court rejected an application for judicial review of HMRC's refusal to grant the nine claimants, all of whom had operated employee benefit trusts (EBTs), the full benefits of the Liechtenstein disclosure facility (LDF). The court dismissed the claimants' application for judicial review on the basis that their applications were never registered and therefore they had no legitimate expectation to receive full benefit of the LDF, and there had been no abuse of power or error of law by HMRC.

Background

In 2011, the claimants engaged in correspondence with HMRC about whether the LDF could be utilised to settle disputed liabilities arising from their EBTs. During these discussions HMRC indicated this would be possible.

In July 2013, HMRC advised the claimants that it was reviewing the benefits available under the LDF. Towards the end of 2013, the claimants applied for registration and HMRC then put their applications on hold pending review. The claimants' applications were subsequently never registered.

Notwithstanding the earlier discussions, in 2014, HMRC advised the claimants that the full LDF benefits were not available to them as there had been on-going enquiries into their EBT arrangements at the time the application was made. The claimants were advised that only limited LDF benefits would be available to each of them.

The claimants challenged HMRC's decision by way of an application for judicial review.

The High Court's decision

In dismissing the claimants' application for judicial review, the court considered the following issues:

- whether the claimants had a legitimate expectation to any substantive benefits under the LDF
- whether HMRC's decision was "conspicuously unfair" (ie so unfair so as to amount to an abuse of power) and
- whether HMRC failed to take into account all relevant considerations or to give proper prominence to those considerations which favoured the continuation of full LDF benefits for the claimants.

Legitimate expectation

The judge commented that although the LDF was capable of engaging the doctrine of legitimate expectation, the LDF merely invited taxpayers to apply for registration; it offered them no promise that their applications would be accepted and without registration there could be no legitimate expectation. The court therefore concluded that as the claimants' applications were never registered, the claimants could have no legitimate expectation to the full benefits under the LDF.

Conspicuously unfair
With regard to this ground, the judge commented that as the claimants had no legitimate expectation to the full benefits under the LDF it would be difficult for them to show "conspicuous unfairness" in HMRC's decision to deny them full LDF benefits because the claimants had no expectation that they would receive such benefits in the first place. However, notwithstanding this observation, the court considered each of the arguments put forward by the claimants in support of their contention that HMRC's decision was so unfair so as to amount to an abuse of power.

- The claimants were induced by HMRC to believe that they would receive the full benefits of the LDF but at the 11th hour and without warning many of the benefits available under the LDF were withdrawn.
  - Whilst the judge accepted that the claimants had been "led up the garden path" by HMRC by being encouraged to use the LDF, the claimants were not given any assurances that they would receive full benefits under the LDF and therefore HMRC's decision was not so unfair that it should not be allowed to stand (*R v IRC ex p Unilever plc* [1996] STC 681 applied). This argument was therefore rejected.
- The treatment received by the claimants was contrary to HMRC's own published policy.
  - The judge commented that the LDF itself stipulated that full LDF benefits would only be available to taxpayers who were registered. As the claimants were never registered, the judge concluded that HMRC's decision to deny the claimants full LDF benefits was not a departure from the stated policy. In the view of the judge, this argument was misconceived and he rejected it.
- The decision in fact reflected a decision in principle made six to twelve months earlier and such backdating was therefore retrospective in effect.
  - The judge concluded that this argument must also fail for the same reasons stated above, namely, that the benefits conferred under the LDF were conditional upon registration under the LDF. Throughout the relevant period, the claimants were never registered and therefore there was no "backdating". Rather, there was merely a change in the terms of the LDF available with prospective effect to those taxpayers who became registered after that date.
- HMRC's decision was discriminatory because others in a materially identical situation to the claimants were permitted to benefit from the LDF without limitation.
  - The judge said that such taxpayers were in a different position to the claimants because their applications had been accepted and registration certificates had been issued to them. Taxpayers in such a position did have a legitimate expectation to the full benefits under the LDF because their applications had been accepted and their eligibility for those benefits had been confirmed. This argument was rejected.
  - The court therefore concluded that it was unable to accept that HMRC's decision had been "conspicuously unfair".

HMRC failed to take into account all relevant considerations
The judge considered in detail the factors which HMRC had taken into account before reaching its decision. Amongst the many factors considered were: (i) the significant adverse tax yield implications of permitting any of the EBT users to settle by means of the LDF; (ii) the interests of taxpayers generally, that tax will be collected in accordance with the statute; (iii) the purpose of the LDF, which was to enable HMRC to reach settlements and realise tax from taxpayers whose liabilities had previously been unknown to HMRC; (iv) the possible reputational damage to HMRC, and the possibility of legal action, if HMRC permitted the LDF to be used for EBT settlements; (v) HMRC's Litigation and Settlement Strategy, which sets out HMRC's policy on reaching settlements

with taxpayers; (vi) the comparatively less advantageous terms of the EBT Settlement Opportunity, through which some EBT users had settled; and (vii) the non-availability of the LDF to those EBT users who did not have any foreign assets at the relevant date.

The judge did not consider that any material consideration had been left out or given inappropriate weight by HMRC in arriving at its decision. No fault could be identified in its approach or evaluation.

Comment

What is perhaps most interesting about this case is the fact that other taxpayers who utilised EBTs were allowed to use the LDF. HMRC claims that it treats all taxpayers in similar circumstances the same. The claimants in this case may take issue with this claim. HMRC must be seen to treat all taxpayers equally. No taxpayer should be treated more favourably than another and HMRC should not allow itself to be influenced by policy consierations when implementing this policy.

The decision is available to view here.

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About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 78 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

"... the client-centred modern City legal services business."

At RPC we put our clients and our people at the heart of what we do:

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- **Winner – Law Firm of the Year – The Lawyer Awards 2014**
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