Tax update

May 2016

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Three new criminal offences

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Castledine – deferred shares are to be treated as ordinary shares for the purposes of entrepreneurs' relief

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Any comments or queries

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About this update

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

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

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Disguised remuneration

In the 2016 Budget, the Chancellor announced proposed legislation to tackle so-called "disguised remuneration". HMRC has now published an impact note and draft legislation. The legislation is designed to prevent attempts to circumvent the disguised remuneration legislation by inserting an additional targeted anti-avoidance rule with effect from 16 March 2016.

The draft legislation and impact note is available to view here.

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Three new criminal offences

Part 10 of the Finance Bill 2016, contains three new proposed criminal offences aimed at tackling tax evasion.

The new offences criminalise failure to (1) give notice of liability to income or capital gains tax, (2) provide a return or (3) make an accurate return. These offences will be strict liability offences which means that it will not be necessary for the Crown to prove an intention to evade tax on the part of the taxpayer.

The new criminal offences will apply only if the tax liability in question exceeds the threshold amount, which will be set by HM Treasury in regulations and must not be less than £25,000.

HMRC has confirmed that the new offences will not take effect before April 2017 at the earliest.

The Finance Bill 2016 is available to view here.

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HMRC consults on new corporate offence

HMRC has begun consulting on draft legislation concerning the introduction of a corporate offence of failing to prevent the criminal facilitation of tax evasion.

The government's intention is for the offence to apply to:

- UK companies which fail to prevent those who act on their behalf from criminally facilitating a UK tax loss
- non-UK companies who fail to prevent those who act on their behalf from criminally facilitating a UK tax loss
- UK based companies who fail to prevent those who act on their behalf from criminally facilitating a tax loss overseas where the laws in place are equivalent to provisions in the UK.

The consultation closes on 10 July 2016 and is available to view here.

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Case reports

Easinghall Limited – review letter from HMRC cancels discovery assessment

In *Easinghall Limited v HMRC* [2016] UKUT 105 (TCC), the Upper Tribunal (UT) has confirmed that where an agreement has been reached with HMRC under section 54, TMA 1970, it cannot commence an enquiry or issue a discovery assessment unless they concern an issue which was not the subject of the agreement.

Background

In June 2012, HMRC opened an enquiry into the tax return of Easinghall Limited (Easinghall) for the year 2010/11, pursuant to paragraph 24, Schedule 18, FA 1998. The enquiry was conducted by Mr Laurie (L). L concluded that Easinghall had understated its profits for the relevant period and issued a closure notice amending its return accordingly.

By the time L issued the closure notice, Easinghall had submitted its tax return for 2011/12. L considered it was likely it had understated its profits for 2011/12. L could have opened an enquiry into this return, but instead he chose to issue a discovery assessment pursuant to paragraph 41, Schedule 18, FA 1998, on the basis that Easinghall had carelessly or deliberately brought about an underassessment of tax (paragraph 43, Schedule 18, FA 1998). He also imposed penalties in respect of both 2010/11 and 2011/12.

Easinghall appealed against the closure notice and amendment to its 2010/11 tax return, the discovery assessment in respect of 2011/12 and the imposition of penalties.

A review was conducted by another HMRC officer, Mr Musgrove (M), who determined that the 2010/11 tax return had been understated. However, he concluded that there was insufficient evidence to support the amount assessed in respect of 2011/12. The assessment and penalty for 2011/12 were therefore cancelled. Under section 49F(2), TMA 1970, the conclusions of a review are to be treated as if they were settled by agreement under section 54(1), TMA 1970.

Easinghall appealed to the First-tier Tribunal (FTT) in respect of M's decision concerning 2010/11.

Notwithstanding the conclusion reached by M, L decided to open an enquiry into Easinghall's 2011/12 tax return and sent a formal notice to it requiring documents and information.

Easinghall applied to the FTT for a direction that HMRC close its enquiry. That application was dismissed.

Easinghall appealed the FTT's decision to the UT.

UT's decision

The UT reviewed the FTT's decision and concluded that it had erred in not considering the wording of M's letter in the context of the relevant statutory provisions. The correct question was not why M arrived at the conclusion he did but rather what that conclusion was.

In its view, M had been very clear in his letter as to the particular matter in question, which was a restatement of HMRC's view of the matter and his conclusions. His conclusions were that the discovery assessment and penalty assessment in respect of 2011/12 should be cancelled. Accordingly, HMRC was bound by M's letter and the FTT should have directed HMRC to close

the enquiry into Easinghall's 2011/12 tax return because the parties are treated as having agreed that there was no understatement of business takings by Easinghall for that year, by section 49F(2), TMA 1970.

Comment

Given that section 49F(2) provides that the conclusions of a review are to be treated as if they were settled by agreement under section 54(1), TMA 1970, it is surprising that HMRC thought they were entitled to open an enquiry into 2011/12.

Where an agreement has been arrived at under section 54(1), it is not open to HMRC to open an enquiry or issue a discovery assessment, unless they relate to an issue which was not agreed between the parties and was not therefore the subject of the section 54 agreement.

The wording of any agreement, or deemed agreement, with HMRC needs to be carefully considered. If the scope is too narrow, HMRC may be able to come back for a second bite of the cherry.

The decision is available to view here.

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Castledine – deferred shares are to be treated as ordinary shares for the purposes of entrepreneurs' relief

In *Alan Castledine v HMRC* [2016] UKFTT 145, the FTT dismissed Mr Castledine's appeal and found that deferred shares qualified as ordinary shares for the purposes of entrepreneurs' relief.

Background

Mr Castledine claimed entrepreneurs' relief for the years 2011/12 and 2012/13, in respect of the disposal of loan notes in Dome Holding Limited (DHL). The only issue between the parties was whether the test for eligibility for such relief in section 169S, TCGA 1992 (at least 5% of the ordinary share capital held by the individual), had been satisfied.

The issued share capital of DHL at the relevant time included both ordinary shares and deferred shares.

If the deferred shares were counted as ordinary shares, Mr Castledine would hold 4.99% of the ordinary share capital of DHL and would not qualify for entrepreneurs' relief. However, if the deferred shares were excluded, Mr Castledine would hold 5% of the company's share capital and would qualify for entrepreneurs' relief.

On 29 July 2011 and 31 July 2012, Mr Castledine disposed of his loan notes for £600,303 and £505,009, respectively. This gave rise to chargeable gains. Mr Castledine's claim for entrepreneurs' relied was rejected and he appealed to the FTT.

FTT's decision

Under DHL's articles of association, the deferred shares had neither voting rights nor rights to dividends. They could only be redeemed at par on capital realisation after at least £1 million had been distributed in respect of each ordinary B share. As there were at the relevant time 2,001,985 B shares in issue, Mr Castledine argued that the deferred shares had in reality no rights.

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The FTT noted that the class of deferred shares was created for commercial reasons. It was a way of removing the ordinary B shares from senior management of DHL when they left the company and taking away any influence they might otherwise have over the running of the company. Under DHL's articles, ordinary B shares were automatically converted into deferred shares in the case of certain "conversion events", including the holder leaving the employment of the company.

Mr Castledine submitted that Parliament did not intend to categorise as ordinary shares holdings which had none of the characteristics of an ordinary share. The FTT was referred to the definition of "shares" contained in section 540, Companies Act 2006, which provides that share means a "share in the company's capital". This implies that there must be a quantifiable sum of money related to each share which entitles the holder to certain rights. In this case, the deferred shares deliberately did not entitle the holder to any rights and were shares in name only.

HMRC argued that the legislation was unambiguous and clear. The legislation defined an easily applied dividing line giving rise to no uncertainty. Accordingly, there was no need and no justification for the FTT to go beyond the plain words of the statute.

The FTT concluded that the intention of Parliament was to give the term "ordinary share capital" a wide interpretation. This was clear from the broad definition provided in section 989, ITA 2007, by the words in parenthesis "however described".

Whilst acknowledging that the arguments were finely balanced, the FTT felt it was unable to depart from the plain language of the legislation under consideration and concluded that the deferred shares fell within the meaning of "ordinary share capital" in section 989. Mr Castledine's appeal was therefore dismissed.

Comment

Mr Castledine will no doubt feel aggrieved by this decision. As a result of the interpretation of the legislation preferred by the FTT, he has failed to qualify for entrepreneurs' relief due to holding 0.01% too little of the company's share capital.

It is interesting to note that in this instance, HMRC was content to argue that there was no need for the FTT to go beyond the plain wording in the statute. Of course, as many readers will be aware, when taxpayers argue that the plain wording of a statute should be followed, HMRC often contends that a purposive approach to statutory construction should be adopted.

The decision is available to view here.

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Revell – FTT rules HMRC's enquiry invalid

In *Revell v HMRC* [2016] UKFTT 97, the FTT has concluded that a purported enquiry by HMRC into an unsolicited tax return was invalid and allowed the taxpayer's appeal.

Background

Following a reconciliation of the taxpayer's PAYE records from various employers, HMRC formed the view that there had been an underpayment of tax. HMRC sent a request to deliver a return for 2008/09 to what it believed to be the taxpayer's last known address. However, HMRC sent the request to the wrong address, despite having received the updated address for

the taxpayer in form P60. Not surprisingly, the taxpayer did not receive the request and did not complete a return for 2008/09. HMRC therefore issued a determination of tax due pursuant to section 28C, TMA 1970 (determination of tax where no return delivered).

The taxpayer proceeded to complete a self-assessment return for 2008/09 voluntarily (the return). This had the effect of applying a notional credit resulting in no tax being shown as due for that year.

HMRC commenced an enquiry into the return and on conclusion of its enquiry issued a closure notice to the taxpayer informing him that it had concluded that the tax credit should be removed and therefore further tax was due.

The taxpayer appealed the conclusions contained in the closure notice.

FTT's decision

The taxpayer argued that HMRC had not validly opened an enquiry as no valid request to file a return had been made by HMRC (section 8, TMA 1970).

The FTT considered whether the taxpayer was required by a notice given to him by HMRC to make and deliver a return for 2008/2009. It concluded that the notice had not been properly served in accordance with section 115, TMA 1970, as at the time the request was made the address to which it was sent was no longer the last known place of residence of the taxpayer. The presumption of service in section 7, Interpretation Act 1978, could not apply.

HMRC informed the FTT that it receives approximately 350,000 unsolicited returns a year and that it treats such returns as if they had been submitted in response to a notice under section 8, TMA 1970, to make a return. Accordingly, it contended that the return should be treated as if it had been submitted in response to a section 8 notice.

This submission was rejected by the FTT. The FTT was of the opinion that there was no basis for the submission that by making an unsolicited return the taxpayer had waived the requirement for a notice to file under section 8. If Parliament had intended such a result, it would have so provided in the legislation. In the FTT's view, the return should be characterised as a notice of liability to income tax under section 7, TMA 1970, rather than a self-assessment return.

As HMRC had failed validly to serve a request for a return pursuant to section 8, TMA 1970, it was unable to issue a determination notice, open an enquiry, or issue a closure notice (under sections 28C, 9A and 28A, TMA 1970, respectively).

The taxpayer's appeal was therefore allowed.

Comment

The effect of this decision is that HMRC must issue a notice to file under section 8, TMA 1970, in order to preserve its ability to open an enquiry under section 9A, TMA 1970. Without such a request, it will not be able to open an enquiry into an unsolicited return submitted by a taxpayer, although it may seek to issue a discovery assessment under section 29, TMA 1970 (provided it is in time to do so). Other taxpayers who have filed unsolicited returns should review their position as soon as possible as they may be able to challenge the validity of HMRC's enquiries into those returns.

Given that HMRC receives approximately 350,000 unsolicited returns a year, this decision could place a huge administrative burden on HMRC which may influence its decision whether to appeal to the UT.

The decision is available to review 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.

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