Analysis

Information notices: the domicile match

Speed read

There have been conflicting decisions as to whether the tribunal can determine an individual's domicile status prior to the individual being required to comply with an information notice regarding their non-UK tax position. In *Levy* and *Perlman*, the FTT considered the tribunal could not do so, holding that *Vodafone 2* was no authority for the proposition that the tribunal could decide mixed issues of law and fact; however, in *Henkes*, the FTT disagreed. Meanwhile, the Upper Tribunal ruling in *Embiricos* effectively found that domicile could be addressed as a preliminary issue only where both sides agree. In practice, taxpayers should expect to have to comply with an HMRC information notice into their non-UK tax position before challenging any decision on domicile. It is hoped that the Court of Appeal will provide clarity on this issue when it considers the appeal in *Embiricos* next year.

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Why domicile matters

Clients are justified feeling some confusion when their English lawyer explains the meaning of 'domicile' under English law. Domicile does not mean nationality. It does not mean residence (despite sounding similar to the terms in French, Italian, Spanish, Catalan etc.). It does not mean citizenship.

But clients should persevere in seeking to understand domicile. Domicile means the jurisdiction to which an individual feels the greatest personal attachment. An individual will form a domicile of choice in any jurisdiction if: (i) the taxpayer is physically present in that jurisdiction; and (ii) the taxpayer has formed an intention to reside in that jurisdiction permanently or indefinitely.

While reforms in 2017 restricted the role of domicile by creating the concept of 'deemed domicile' in the case of long-term residents (at least 15 of the last 20 years) in the UK, domicile still carries significant weight in respect of tax in the UK. As readers will know, an individual domiciled in the UK is subject to UK inheritance tax on their worldwide assets, and they are liable to UK tax on income and gains wherever it arises (the arising basis of taxation). If an individual is not UK domiciled, only their UK assets will be subject to UK inheritance tax. In addition, they can claim the remittance basis of taxation and so pay tax only on the income and gains brought or used for their benefit in the UK, typically resulting in a lower tax burden.

The dangers of a domicile enquiry

HMRC can challenge a taxpayer's claim for the remittance basis if it concludes the taxpayer is not UK domiciled. As the test for domicile depends on an individual's attachment to the jurisdiction, a domicile enquiry by HMRC potentially involves a significant (and time-consuming) factual analysis.

In addition, an individual who has elected to use the remittance basis does not report their worldwide income and gains to HMRC. If HMRC considers that the remittance basis was used incorrectly, it will likely ask the taxpayer to provide their income and gains on a worldwide basis. HMRC may seek this information informally, but it also has the power to request information under FA 2008 Sch 36 para 1 (by means of a taxpayer notice). Responding to a taxpayer notice may be time-consuming and costly.

While questions about personal attachments to a jurisdiction are unavoidable, taxpayers may be reluctant to provide information which will allows HMRC to calculate potential tax liability on the basis of a view with which the taxpayer disagrees.

How to resist an enquiry

Recent cases address a number of taxpayer challenges to HMRC enquiries. Those challenges have been made by way of a few different (but related) routes.

First, taxpayers have pointed out that a taxpayer notice must be reasonably required by HMRC. Taxpayers have argued that it is unreasonable to provide their worldwide income and gains before HMRC has proven that the taxpayer is indeed UK domiciled. Therefore, any domicile question should be dealt with in priority.

Second, taxpayers have applied to the First-tier Tribunal (FTT) to request that the tribunal order HMRC to issue a closure notice. Closure notices balance HMRC's right to investigate taxpayers' rights not to have enquiries continue for unreasonably long periods of time. Typically, a taxpayer will apply for a closure notice where HMRC has delayed their investigation unnecessarily or the taxpayer considers that sufficient information has been provided. In these cases, most of the taxpayers did not merely argue that a particular enquiry had run its course, but that no enquiry could be sustained because it was clear that the taxpayer was not UK domiciled. The tribunal was effectively asked to determine the substantive matter (rather than merely decide if the enquiry was proportionate).

Since 2017, partial closure notices (PCN) can be issued with respect to any 'matter' to which an enquiry relates. This is in addition to the final closure notices (FCN), previously the only option open to HMRC. FCNs would end all enquiries into a tax return that HMRC were investigating. Some taxpayers have used PCNs to argue that the domicile question can be resolved as a matter of principle, whilst preserving the rest of the enquiry should it then be necessary to determine any liability to tax.

HMRC 1 – taxpayer 0: HMRC takes the lead with *Embiricos*

Mr Embiricos claimed the remittance basis of taxation in his tax returns and therefore did not pay UK tax on his worldwide income. HMRC investigated Mr Embiricos and concluded that he was not entitled to claim the remittance basis because he was UK domiciled. HMRC wanted to go on and determine Mr Embiricos' tax liability on the arising basis and issued a taxpayer notice. Mr Embiricos disagreed. Mr Embiricos applied to the FTT for a direction that HMRC should issue a PCN in respect of HMRC's enquiry into his domicile. That would allow Mr Embiricos to appeal HMRC's conclusion as to his domicile and for the matter to be resolved before the tribunal, without needing to provide information about a tax liability that would not arise unless HMRC were correct. Accordingly, Mr Embiricos also resisted the taxpayer notice, stating that it was not reasonable to provide such information before the domicile question had been resolved.

Unlike the cases below, Mr Embiricos was not asking the tribunal to determine his domicile in these proceedings, but to sanction a route that would allow the parties to resolve the domicile question before considering what tax might ultimately be payable.

The Upper Tribunal (*Embiricos v HMRC* [2020] UKUT 370 (TCC)), agreed with HMRC (overturning the decision of the FTT ([2019] UKFTT 236 (TC)), holding that domicile was not a standalone issue and could not be separated from the amount of tax payable. No PCN could be issued. Accordingly, Mr Embiricos was obliged to provide information in respect of his worldwide income and gains for HMRC to complete their enquiries.

It is understood that the Court of Appeal will hear an appeal in *Embiricos* in February 2022. This will be particularly interesting given the various cases that have followed.

HMRC 2 – taxpayers 0: HMRC extends its lead with *Levy*

The decision in *The executors of Levy v HMRC* [2019] UKFTT 418 (TC) was released after the FTT's decision in *Embiricos* but before the Upper Tribunal's judgment. In *Levy*, the taxpayer (since deceased) had claimed the remittance basis. But HMRC's view was that the taxpayer should pay tax on the arising basis because she had a UK domicile of choice. The taxpayer asked the tribunal to direct HMRC to issue an FCN in respect of the enquiry as a whole or a PCN in respect of HMRC's conclusion on domicile. The taxpayer's case was that no enquiry into domicile could be maintained, because it was clear that she was non-domiciled. The taxpayer also appealed the taxpayer notice (if no enquiry could be maintained, neither could the notice). The arguments were similar to those in *Embiricos* but with the distinction that the taxpayer was asking the tribunal to reach a conclusion on her domicile as part of the application.

Scott J in the FTT dismissed the taxpayer's request for closure notices. The taxpayer had relied on *HMRC v Vodafone 2* [2016] EWCA Civ 1132, in which the Court of Appeal had concluded that a question of law could be determined in an application for a closure notice. However, domicile is a question of fact as well as law. Scott J's view was that, while the tribunal could consider matters of law that would render an enquiry unreasonable, it could not easily reach the same position where disputed matters of fact were involved. The taxpayer therefore could not rely on *Vodafone 2*.

More generally, Scott J's view was that the statutory scheme relating to closure notices required a 'supervisory approach' by the tribunal. The tribunal needed only to satisfy itself that HMRC's view on a taxpayer's domicile had some merit that would sustain an enquiry. The question of whether HMRC has reasonable grounds for their view of a taxpayer's domicile is 'very different' from deciding a substantive argument relating to domicile. HMRC must merely show that they have a genuine case; that is, the enquiry is not a spurious investigation into an issue that could not on any reasonable view arise.

The same type of reasoning applied with respect to taxpayer notices. Scott J relied on cases such as *Derrin Brothers Properties Ltd and others v HMRC and others* [2016] EWCA Civ 15, in which the Court of Appeal concluded that FA 2008 Sch 36 as a whole operates at an early stage of an HMRC investigation. The statutory mechanism was designed to allow HMRC to seek the information it needed, with a supervisory role for the tribunal. It was not intended to give rise to complex or lengthy adversarial proceedings, and it would not be appropriate to shoehorn in substantive disputes relating to domicile.

> Taxpayers should expect to have to provide details of overseas income and gains if HMRC concludes that they are domiciled in England and Wales – and if HMRC asks for them – before HMRC's decision on domicile can be challenged

The approach was reinforced by the High Court in *Kotton v HMRC and others* [2019] EWHC 1327 (Admin). In *Kotton*, Simler J (as she then was) determined that the role of the tribunal in appeals against Sch 36 notices is merely to ensure that the HMRC officers are carrying out 'a genuine and legitimate investigation or enquiry of any kind into the tax position of a taxpayer that is neither irrational nor in bad faith'. A judge's role is limited and they cannot consider the underlying contention between the parties.

Scott J did also consider whether HMRC should be required to issue a closure notice on the basis that their enquiry was disproportionate and had run its course. This argument was not central to the taxpayer's case, but Scott J concluded that, since HMRC lacked any information that would allow it to calculate the quantum of any tax liability, it was fair for HMRC to continue its enquiries in order to seek information as to that potential liability.

HMRC 3 – taxpayers 0: HMRC scores again in *Perlman*

Despite living in the UK for at least 50 years, Mr Perlman argued that he was domiciled in Curaçao (his place of birth). HMRC enquired into Mr Perlman's tax returns and asked Mr Perlman for information and documents to assist them in their enquiry. Mr Perlman refused to provide any and HMRC issued a taxpayer notice. Mr Perlman pointed out that a taxpayer notice could only be issued if 'reasonably required' to check a taxpayer's position and that the taxpayer notice could not be

reasonably required until it was first proven whether he was UK domiciled.

The FTT (*Perlman v HMRC* [2021] UKFTT 219 (TC)) rejected Mr Perlman's position, with Redston J finding that domicile could not be determined as a preliminary issue. She held that the tribunal did not have jurisdiction to conclude on domicile, adopting much the same reasoning as Scott J in *Levy*. In short, *Vodafone 2* could not be used as authority for the proposition that the tribunal could decide mixed issues of law and fact.

In line with the view of Scott J in *Levy*, Redston J's view was that even if the tribunal had the power to determine questions of domicile, the tribunal should not exercise that power in these circumstances because submissions regarding domicile are complex and often involve many days of contested witness evidence. That process could not (and should not) be accommodated in preliminary hearings.

HMRC 4 – taxpayers 0: the taxpayer scores in *Henkes*, but it is an own goal

In *Henkes v HMRC* [2020] UKFTT 159 (TC) (determined before *Perlman*), HMRC considered the taxpayer was UK domiciled and therefore could not benefit from the remittance basis of tax. The taxpayer adopted the two-pronged approach of applying to the tribunal for FCNs in respect of the tax years under enquiry by HMRC in order to bring the enquiries to a complete close or, in the alternative, for PCNs to be issued in respect of the domicile question alone. As with *Levy* and *Perlman*, the taxpayer did not contest how HMRC was conducting its enquiries. For HMRC to issue FCNs or PCNs, HMRC must show that it has acted reasonably in not closing its enquiries to resist a taxpayer's application for FCNs and PCNs. Similarly, HMRC could only seek information that was reasonably required to check a taxpayer's tax position. Instead, the tribunal was again asked to determine the substantive issue.

Beare J found that domicile *could* be determined as a preliminary issue by the tribunal, disagreeing with Scott J's interpretation of *Vodafone 2*. Beare J's view was that, even though *Vodafone 2* distinguished between questions of law and questions of fact, the precedent gave the tribunal authority to decide any 'threshold issue'. The fact that a threshold question may be a 'mixed question of law and fact' was not a barrier. If a question was a binary question capable of bringing proceedings to a close, the tribunal was capable of determining the point. Domicile is a threshold issue because, if the tribunal finds that the taxpayer is not UK domiciled, there is no reasonable basis on which HMRC can resist issuing an FCN or PCN.

Beare J went on to find that the tribunal *should* determine domicile as a preliminary issue. When balancing HMRC's duty to obtain the correct amount of tax with a taxpayer's right to avoid unnecessarily protracted uncertainty over their tax position, Beare J thought it appropriate for the tribunal to deal with domicile, given the time and cost savings made if the issue were resolved promptly. It appears that Beare J was particularly swayed by the duration of the HMRC enquiries.

Unfortunately for the taxpayer, having invited the tribunal to make a determination on the substantive issue, Beare J found that the taxpayer was UK domiciled. Even worse, any appeal route is unclear. The tribunal agreed with the taxpayer's application requiring HMRC to issue a closure notice. But the taxpayer cannot then appeal that closure notice on the basis that he is non-domiciled because the tribunal found otherwise.

Match highlights

Taxpayers should expect to have to provide details of overseas income and gains if HMRC concludes that they are UK domiciled – and if HMRC asks for them – before HMRC's decision on domicile can be challenged.

As a result of current decisions, there is no simple answer to this burden. The Upper Tribunal in *Embiricos* suggested that domicile could be addressed as a preliminary issue but that requires agreement from both sides: in practice, HMRC may be unlikely to agree. It is possible, however, that this position will change with any appeal in *Embiricos*.

In other contexts, HMRC will issue closure notices on the understanding that quantum will need to be determined in due course. As it stands, this may be largely at the discretion of HMRC.

In addition to the legal question, there is a strategic question. In *Henkes*, the taxpayer lost the gamble by persuading the tribunal to consider his domicile status but failing to convince the tribunal he was not domiciled ... As a result, a taxpayer can put themselves in a worse position than if they wait and appeal a closure notice

There is disagreement over whether *Vodafone 2* supports the tribunal in resolving only issues of law or whether the tribunal can also decide issues such as domicile, which are mixed issues of fact and law. *Levy* and *Perlman* considered the tribunal could not, but *Henkes* disagreed. *Levy* did, however, acknowledge that the tribunal could consider the issue to a certain degree, i.e. whether there was a case to answer. It may be, therefore, that a tribunal would at least be tempted to address the substantive question of domicile where it considers that the answer is clear.

In addition to the legal question, there is a strategic question. In *Henkes*, the taxpayer lost the gamble, by persuading the tribunal to consider his domicile status (the procedural argument) but failing to convince the tribunal he was not UK domiciled (the substantive argument). As a result, a taxpayer can put themselves in a worse position than if they wait and appeal a closure notice.

Overall, however, the tribunal may accept only a limited supervisory role when considering challenges to an enquiry or to information notices, leaving taxpayers with limited rights of appeal. ■

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- Information overlord (H Gunson, D Lawrance & C Harrison, 21.7.21)
- *Embiricos* and the future of partial closure notices (H Gunson, D Lawrance & C Harrison, 11.2.21)
- *Henkes*: the rapid resolution of domicile disputes (N Clayton & D Gao, 28.5.20)