Briefing

Private client review for September

Speed read

This month, we report two recent cases, *Shah* and *Strachan*, which serve as a reminder that domicile claims may lead to detailed scrutiny of a taxpayer's personal affairs in a public forum. Recent taxpayer statistics highlight that HMRC are netting record amounts of inheritance and capital gains tax, whilst the 'tax gap' and the number of 'non-dom' taxpayers remain relatively steady. The much-reported case of *A Taxpayer* indicates that sufficient evidence is key in a taxpayer successfully establishing 'exceptional circumstances' under the statutory residence test and on this topic, HMRC are closely scrutinising related claims from the Covid era. Finally, the cases of *Vision HR Solutions Ltd* and *Stenhouse* serve as reminders that permission for judicial review is not easily granted by the tribunal.

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To be domiciled or not to be domiciled: that is the question

Many readers may have experienced an increasing HMRC focus on domicile. Two First-tier Tribunal (FTT) decisions (*Shah v HMRC* [2023] UKFTT 539 and *Strachan v HMRC* [2023] UKFTT 617), both in HMRC's favour, may have emboldened them in other enquiries – and offer some important lessons for taxpayers.

In *Shah*, the taxpayer had a domicile of origin in pre-partition India (and therefore either India or Pakistan for modern purposes). He had been resident in the UK continuously from 1973 until his death in 2016. His executors argued that he had never acquired a domicile of choice in England because he had retained an intention to return to India throughout his life. They therefore claimed exemption from inheritance tax on non-UK assets under the UK/India or UK/Pakistan estate tax treaties.

The FTT found that Mr Shah had acquired a domicile of choice in England before his death. In particular, the FTT placed emphasis on the facts that (i) Mr Shah had only travelled to India twice during the forty years he had lived in the UK; and (ii) significant moments in life which might have triggered a move, including his retirement and the deaths of his wife and daughter, had passed without any move taking place.

That context made Mr Shah's case comparatively weak, but the decision nonetheless confirms that taxpayers cannot rely on an abstract intention to return to their place of origin to maintain their non-domicile status. It is important not only to have a clear timeline of when and in what circumstances they will leave the UK, but also to have evidence of that plan and take steps to implement it in a reasonable timeframe. Where there is a supposed plan to leave the UK at a given point (e.g. on retirement, or on a child finishing school), it is clearly very dangerous (if not actually fatal) to allow that point to pass without leaving (or perhaps re-setting the trigger event).

In *Strachan*, the taxpayer had an English domicile of origin and asserted successive domiciles of choice in Connecticut and Massachusetts. Mr Strachan argued that to acquire a domicile of choice he had to (i) acquire a home in the relevant jurisdiction; and (ii) intend to end his days there. The FTT found that the proper test is wider; the taxpayer must establish a 'chief residence' in the jurisdiction, which they found to be a broad factual test involving a comparative assessment of all aspects of the taxpayer's life.

> Two recent FTT decisions, *Shah* and *Strachan*, may have emboldened HMRC in other domicile enquiries – and offer some important lessons for taxpayers

As in *Shah* and other recent cases, the FTT examined the taxpayer's life in detail (including extended family, holiday destinations, investment choices etc). Taxpayers considering litigation should be prepared for this level of scrutiny – and bear in mind that minute details about their lives are likely to appear in a public judgment regardless of the outcome of the case.

Strachan also involved an interesting decision on carelessness (a topic covered in our May update). Mr Strachan had filed 2011/12 and 2012/13 tax returns as a non-domiciliary despite not having taken advice on his domicile since 1987. HMRC only had the power to issue discovery assessments for those years if the loss of tax arising from his incorrect domicile claim was caused by Mr Strachan's carelessness. The FTT found that he had been careless in not taking advice, but, crucially, the burden of proof that this carelessness had caused the loss of tax remained with HMRC. Since a reasonably competent adviser could plausibly have advised that Mr Strachan was non-UK domiciled, such that he might have made the same filings even if he had taken advice, HMRC could not prove that the careless failure to take advice had caused a loss of tax. This is arguably a subtle interpretation of the point and one not often seen in such decisions.

Taxpayer statistics: good news for HMRC

A spate of tax-related statistics have become available, with HMRC releases including the annual figures on the

'tax gap', inheritance tax, capital gains tax and non-doms. The figures paint an encouraging picture for HMRC, showing a steady tax gap and an increase in tax receipts elsewhere.

The 'tax gap' is the difference between the amount of tax that HMRC estimate that they should receive, and the amount they actually receive. The figures recently released for 2021/22 show that the 'gap' remained at an all-time low of 4.8%, which puts the gap at £36bn for 2021/22 (an increase of £5bn on the previous year, but steady as a percentage of estimated tax liabilities). Individuals still bear a relatively small portion of the 'gap', with the gap principally being attributed to small businesses (56%), mid-sized businesses (11%), large businesses (11%) and criminals (11%).

Regarding taxes borne by individuals, record highs were hit in both inheritance tax and capital gains tax liabilities. HMRC recently reported total inheritance tax liabilities of £5.76bn for 2020/21 (an increase of 16% on the previous year and surpassing the previous peak in 2016/17), and capital gains tax liabilities of £16.7bn for 2021/22 (an increase of 15% on the previous year). Notably, the number of taxpayers paying capital gains tax increased by 20% to another record high of 394,000 – presumably, as the impact of reductions in the annual allowance is shown, this figure will rise.

On smaller subsets of the individual taxpayer population, HMRC also released figures relating to self-assessment claims for non-UK domiciled (or 'non-dom') treatment. The number of non-doms remained fairly stable, but HMRC nonetheless reported an increase in total income tax, capital gains tax and NICs liabilities to £8.49bn for non-doms in 2021/22, an increase of around £500 million on the previous tax year and the highest figure since 2016/17 (when wide-reaching changes to the taxation of non-doms resulted in a significant number of individuals becoming 'deemed' domiciled). Although the total tax take from non-doms was consistently higher overall in the years up to 2017, the £8.49bn figure reported for 2021/22 represents the most tax per non-dom since figures began in 2008.

Note that not all of these reported 'non-doms' are remittance basis users. The statistics relating to the remittance basis are out of step, being published a year in arrears, and report 37,000 remittance basis users in 2020/21 (of a total 68,000 non-doms in that year).

The non-dom regime has of course been the subject of recent political scrutiny, and the question is whether any touted changes can increase the total tax take from this relatively small proportion of the population.

Exceptional circumstances: evidence is key

The Upper Tribunal (UT) recently handed down judgment in *HMRC v A Taxpayer* [2023] UKUT 182 (TCC)), overturning in favour of HMRC the FTT decision in relation to the application of the 'exceptional circumstances' aspect of the UK's statutory residence test (SRT).

The 'exceptional circumstances' test is one of the few subjective elements of the SRT, which is otherwise fairly mechanical and based primarily on the number of days a person spends in the UK. The test allows up to 60 days in a tax year to be discounted for some aspects of the SRT where it can be shown that the taxpayer would not be present in the UK but for 'exceptional circumstances' beyond their control that prevent them from leaving the UK, and that the taxpayer intends to leave the UK as soon as those circumstances permit.

In *HMRC v A Taxpayer,* the taxpayer had filed her 2015/16 tax return on the basis that she was non-resident, which relied on discounting some days as being due to 'exceptional circumstances', having spent a number of days in the UK caring for her twin sister (who suffered from alcoholism and depression) and the twin sister's minor children.

Disagreeing with the FTT, the UT concluded that the 'exceptional circumstances' test had not been met in this case. The judgment is interesting in its coverage of the issues that arise where the 'exceptional circumstances' relate to someone other than the taxpayer, and whether 'moral obligations' are relevant in this context, on which there has been much commentary.

However, the decision is also a useful reminder of the amount of evidence that is required to substantiate these types of claims. The tribunal had been provided with a bundle of documents of over 600 pages (including credit card statements, medical records etc.), and both the taxpayer and her husband provided witness statements and were cross-examined, but the judgment concluded that there was insufficient evidence on a number of points.

> *A Taxpayer* is a reminder of the sheer amount and quality of evidence that is expected to substantiate these claims

The UT stated that it was important to apply the exceptional circumstances test on a 'day-by-day' basis, and emphasised that it was incumbent on the taxpayer to provide sufficient evidence to demonstrate that the test was satisfied for each day the taxpayer was seeking to discount.

The UT did concede that the taxpayer did not have to go so far as to provide an itemised timeline of her movements on the days in question, but at the same time the tribunal was critical of the fact that the taxpayer had known that she would be relying on the 'exceptional circumstances' test but had not made any record of what she was doing or why she was unable to leave the UK on each of the relevant days.

The taxpayer was unable to recall some information about the relevant days, such as why she had made certain payments shown on her credit card statement, or on which days she had stayed overnight with her sister. The FTT accordingly described the taxpayer as being 'vague in relation to details' and refused to accept her evidence on a number of issues.

The case is a reminder of the sheer amount and quality of evidence that is expected to substantiate these claims: taxpayers who realise that they need to rely on the 'exceptional circumstances' test should be careful to collect as much evidence and record as much information as possible to support their claim.

The 'exceptional circumstances' test became more relevant during Covid. Indeed, HMRC are alive to the number of taxpayers who sought to rely on 'exceptional circumstances' in the pandemic, and it has been reported that HMRC have recently dispatched letters to a number of taxpayers who may have exceeded the SRT

requirements during Covid. It may therefore be that we see more of these types of cases.

Judicial review? Don't count on it

Taxpayers tempted to fight back against perceived poor conduct by HMRC should take heed of two cases published in July.

In *R v HMRC ex parte Vision HR Solutions Ltd* [2023] EWHC 1659, the promoters of some tax avoidance schemes sought judicial review of HMRC's decision to 'name and shame' them on its website. They argued first that the legislation enabling this publication (FA 2022 s 86) was a breach of the EU law right to the free movement of capital and went further than could reasonably be justified as a proportionate infringement in the interests of preventing tax avoidance. Alternatively, they argued that the potential loss of future customers for their business meant publication under s 86 was a breach of the Human Rights Act 1998 as an interference with the peaceful enjoyment of their possessions, or as the imposition of a criminal penalty without due process.

Although these arguments were undoubtedly imaginative, they were dismissed categorically by the High Court. The court found that FA 2022, having been passed after Brexit, could not be challenged as a breach of EU law and, in any event, s 86 would have applied equally to a scheme involving exclusively UK individuals and companies as to the claimant's scheme (which involved Maltese companies). Further, human rights law did not require the public to be 'kept in the dark' about the risks of a potential tax avoidance scheme, and it was not realistic to characterise publication on HMRC's website as a 'criminal penalty'.

These cases indicate that, in practice, the bar to achieving judicial review remains (reasonably) high and 'trying your luck' is unlikely to succeed

Readers may have more sympathy for the taxpayer in *Stenhouse v HMRC* [2023] UKFTT 635. Over a number of tax years, Mr Stenhouse had made timely payments to HMRC in full satisfaction of his tax liabilities. However, HMRC repeatedly failed to credit the payments to his self-assessment account and instead issued a series of late payment penalties. The penalties were later cancelled, but Mr Stenhouse nonetheless appealed to the FTT seeking compensation of £1500 for 'worry, anger, frustration and time suffered and wasted' plus £50/day until HMRC provided an accurate statement of account. In a useful reality check for taxpayers with legitimate grievances about HMRC conduct, the FTT found it had no jurisdiction and declined to refer the case for judicial review.

These cases indicate that, in practice, the bar to achieving judicial review remains (reasonably) high and 'trying your luck' is unlikely to succeed. ■

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- Cases: Other cases that caught our eye (*Shah*, 16.6.23)
- Cases: *I Strachan v HMRC* (25.7.23)
- A tax on conscience? A moral dilemma for non-residents (R Waterson & L McKay, 7.9.23)
- Cases: *HMRC v A Taxpayer* (8.8.23)
- Cases: *Vision HR Solutions Ltd and another v HMRC* (8.8.23)