Briefing

Private client review for June

Speed read

This month, we comment on mixed results for the taxpayer concerning information notices, with a challenge against these involving a personal services company denied in *Leen,* contrasting with a taxpayer victory pertaining to privilege in *Refinitiv.* Two tales from the tribunal serve as a reminder that late appeals are not received warmly (in *Tolla*), but that 'special circumstances' may prevail against late filing penalties (in *Marano*). *Murphy* brings clarity on how the courts will construe time limits in an extra-statutory concession and *Bhaur* serves as another reminder of the courts' dim view of tax avoidance schemes. Finally, we comment on recent taxpayer statistics.

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Schedule 36 information notices: a mixed bag

We have commented recently on cases challenging FA 2008 Sch 36 information notices, where taxpayer success is somewhat mixed. Against the recent backdrop of the taxpayer's win in *Davies v HMRC* [2022] UKFTT 369 (TC) (discussed in November), where HMRC's request was denied on procedural grounds, *Leen v HMRC* [2023] UKFTT 407 (TC) is a comeback for HMRC.

In *Leen*, the FTT concluded that information relating to a taxpayer's personal services company (PSC) was disclosable under a Sch 36 notice issued as part of an enquiry into the taxpayer as an individual.

The taxpayer was a retired doctor receiving private consultancy fees via a PSC and had initially disclosed personal bank statements; however, these did not cover the entirety of his consultancy fees. The taxpayer maintained that further disclosure of personal bank statements was not relevant as all fees had been received by his PSC and declared on the company tax return. HMRC noted a discrepancy between the amount reported on the tax return, the company accounts and the taxpayer's breakdown of fees based on the bank statements; on this basis, a Sch 36 notice for documentation relating to the PSC was issued.

The taxpayer argued that HMRC was not entitled to this information as its enquiry related to the taxpayer's personal position and the PSC was not relevant. HMRC's stance (with which the FTT concurred) was that it was entitled to information relating to the PSC due to the close connection between the taxpayer and the PSC, and because the information was relevant to checking the tax position.

Whilst *Leen* may suggest that Sch 36 notices are becoming harder to fight, this case hinged on the fact that there were clear discrepancies in the figures disclosed. The FTT concluded that the PSC 'cannot be deployed as a smokescreen to deflect HMRC's focus on enquiring into the appellant's personal tax affairs', sustaining HMRC's stance that taxpayers as individuals are wholly responsible for their affairs. We have commented on this previously regarding *Rizvi v HMRC* [2023] UKFTT 124 (TC) and related cases where it has been made clear that advisers cannot be deployed as the taxpayer's 'smokescreen'.

One should however not conclude that information relating to PSCs will be disclosable in all instances; this case hinged on the irreconcilable figures provided to HMRC, suggesting that, if all information had been declared initially, the enquiry into the PSC might have been irrelevant. Additionally, the information relating to the PSC was easy to source and was directly relevant, which contrasts with *Davies*.

> As the documents represented 'part of the continuum of communications with a dominant purpose of providing legal advice' between in-house lawyers and the company's senior management, the FTT deemed them subject to legal advice privilege and therefore non-disclosable

In a contrasting success for the taxpayer, the FTT held in *Refinitiv UK Holdings Ltd v HMRC* [2023] UKFTT 222 (TC) that the information sought by HMRC was not disclosable due to legal professional privilege. The dominant purpose of the documents requested had been to provide legal advice relating to a project to change the company structure. HMRC claimed that the documents were necessary for them to consider the applicability of the diverted profits tax provisions. The company, having been subject to historic transfer pricing disputes, had considered it prudent to take legal advice on the restructuring, and documents concerning this were requested by HMRC.

As the documents represented 'part of the continuum of communications with a dominant purpose of providing legal advice' between in-house lawyers and the company's senior management, the FTT (to whom the documents were disclosed direct) deemed the documents subject to legal advice privilege and therefore non-disclosable.

This will be reassuring to taxpayers following the decision in *HMRC v Taxpayer* [2023] UKFTT 71 (TC) where the duty of confidentiality owed to clients by solicitors was considered overridden by the duty to provide information. Whilst the cases' facts were very different, it is perhaps notable that in *Taxpayer* the taxpayer had repeatedly refused to comply with prior information requests, whereas here there had been ongoing dialogue between the parties.

Late appeals and late filing penalties: two tales from the Tribunal

Continuing themes from earlier columns, reasonable excuse and special circumstances were again in the spotlight in *Tolla v HMRC* [2023] UKFTT 400 (TC) and *Marano v HMRC* [2023] UKUT 113 (TCC) respectively.

In *Tolla*, the taxpayer was appealing against income tax and VAT penalties issued following enquiries. Despite repeated efforts by HMRC to inform the taxpayer of their appeal rights and granting time extensions, the taxpayer did not submit their appeals until several years after the relevant deadlines.

The taxpayer argued that this was due to multiple factors, including mental health issues, lack of clarity from HMRC as to the appeal process, and inability to access records due to the seizure of computers by HMRC.

The FTT found in HMRC's favour, noting that none of the arguments raised by the taxpayer constituted a reasonable excuse for the delays. Whilst the FTT had sympathy with the taxpayer's mental health struggles, they carried little weight because the taxpayer had failed to provide supporting medical records. The FTT had much less sympathy with the taxpayer's procedural complaints, pointing to HMRC's repeated attempts to guide the taxpayer through the investigation and appeals process and noting that the seizure of records did not prevent the taxpayer from appealing – instead, it was open to them to appeal and deal with the shortage of information later.

Even with mitigating factors, the length of the delay was considered a major difficulty for the taxpayer's case. The FTT gave significant weight to arguments that there is a limit to the resources HMRC can devote to one taxpayer, and that a lengthy delay could involve serious detriment to HMRC due to the possibility of personnel changes and because evidence may no longer be available because it has 'dropped off' HMRC's systems. HMRC's structure and processes – not deemed limitless or of infinite patience – were therefore seen as relevant factors when assessing reasonableness.

In *Harrison v HMRC* [2022] UKUT 216 (TCC) (and other cases), the tribunals' sympathy for the taxpayers' personal predicaments was evident, but ultimately this could not trump their failure to deal with their affairs in a timely manner. *Tolla* continues this trend.

In *Marano,* the facts were markedly different: the taxpayer was appealing to the Upper Tribunal against tax-geared penalties issued under FA 2009 Sch 55 paras 5 and 6 for failure to file a self-assessment return for 2012/13.

The taxpayer had in fact made a voluntary early payment of tax due on the relevant capital gain, had made payments on account for 2012/13, and his accountants had disclosed the gain to HMRC during the tax year (albeit for foreign tax crediting reasons). HMRC's penalty notices took none of these factors into account.

The UT concluded that the FTT had been wrong to dismiss these factors as irrelevant when considering whether the penalties should have been reduced due to 'special circumstances' (under FA 2009 Sch 55 para 16).

Although neither the early payment nor the notification were relevant to the mechanical question of setting the tax-geared penalty (which is done by reference to what would have been 'shown in a return' rather than how much tax was actually due or payable), this did not stop the factors being relevant when deciding whether the penalty (once determined) should be reduced. The UT also held that the FTT had erred in rejecting the overall proportionality of the penalty as a relevant factor.

Ultimately, the UT did not determine whether 'special circumstances' actually existed (a new FTT panel will decide that), but the case is a notable endorsement of a wider view of the concept. Watch this space for a decision on the quantum of the penalties when applying this wider view from the new FTT panel.

Time after time: claiming credit for income tax paid by trustees

Following commentary last month on time limits in the context of double tax treaties in *Sikder v HMRC* [2023] UKFTT 362 (TC), *Murphy v HMRC* [2023] EWCA Civ 49 deals with consideration of time limits under extra-statutory concession ESC B18. Here, the Court of Appeal explored the scope of ESC B18, which (among other things) allows UK resident beneficiaries of non-UK resident trusts to claim a credit for income tax paid by the trustees on UK source income, where that income has later been distributed to the beneficiaries.

The question was whether this credit was subject to the same time limit as earlier sections of ESC B18 (dealing with other fact patterns), whereby credit can only be given where the income arose to the trustees no more than six years before the end of the tax year in which the distribution is made. This was not explicit in the wording.

> Whilst potentially helpful, *Murphy* arguably raises a question of whether ESC B18 might now be revisited to put the ordinarily sophisticated taxpayer in step with HMRC's view

The court concluded that the six-year time limit did not apply. ESCs are to be interpreted by reference to how they would be understood by 'ordinarily sophisticated taxpayers'. It was held that such a taxpayer would not take the wider structure and wording of ESC B18 to mean that the time limit was imported to the relevant section. Further, the fact that HMRC might have practical difficulties looking back more than six years did not mean an ordinarily sophisticated taxpayer would infer the same thing and conclude that the limit applied.

The court also rejected HMRC's argument that it had always interpreted ESC B18 as if the six-year limit applied, noting that the taxpayer could not be expected to know about internal HMRC practices. Importantly, however, the position might be different if these practices came to be known more widely through HMRC manuals or other commentary. As such, the meaning of an ESC might actually change over time, despite the wording staying the same.

Whilst potentially helpful, *Murphy* arguably raises a question of whether ESC B18 might now be revisited, or additional guidance published, to put the ordinarily sophisticated taxpayer in step with HMRC's view.

No mistake when you knowingly run the risk

We recently discussed a GAAR advisory panel decision and *Pride v HMRC* [2023] UKFTT 316 (TC), which highlight the risks of entering into tax arrangements which have any hint of artificiality. Now, *Amarjit Bhaur and others v Equity First Trustees (Nevis) Ltd and others* [2023] EWCA Civ 534 makes the predicaments faced in the earlier cases somewhat pale in comparison.

In *Bhaur*, the taxpayers entered into a scheme using an employee benefit trust to save an inheritance tax charge on

substantial assets owned by a family business. However, HMRC launched an investigation (still ongoing) into the (highly artificial) structure, meaning that the initial inheritance tax benefit is very unlikely to materialise and much of the family wealth is likely to be lost through associated costs and penalties.

The Court of Appeal considered whether it was possible to set aside the initial asset transfer into trust under the equitable doctrine of mistake, thereby effectively unravelling the scheme. The judge held that here mistake could not be invoked for several reasons. Notably, the fact that the taxpayers 'deliberately chose to implement what they knew to be a tax avoidance scheme, which, to their knowledge, carried a risk of failure and possible adverse consequences' was given considerable weight, suggesting that mistake cannot aid a taxpayer who has chosen to run the risk of being wrong about the factual or legal matter on which they are mistaken.

In short, mistake should not be considered an escape mechanism when a tax avoidance arrangement has knowingly been entered into

It was also made plain that the courts take a very dim view of tax avoidance generally: where it is judged to have occurred, relief is very likely to be denied (in contrast to cases where there is a mistake as to the 'vanilla' tax consequences of a transaction, see our previous discussion of *Hopes v Burton* [2022] EWHC 2770 (Ch)): 'I fully accept that tax avoidance is not unlawful, but … tax avoidance is a social evil that puts an unfair burden on the shoulders of those who do not adopt such measures. In my view this is a weighty factor against the grant of any relief.'

In short, the more artificial a tax mitigation arrangement, the less likely the courts will be to look on this favourably and mistake should not be considered an escape mechanism when a tax avoidance arrangement has knowingly been entered into by a taxpayer.

Let's get statistical

Following HMRC's reports in March 2023 that a record number of taxpayers submitted their self-assessment tax returns on time, further HMRC statistics show the number of those filing their self-assessment returns early has more than doubled since 2018; more than 77,500 taxpayers submitted their 2022/23 returns on 6 April 2023, compared to almost 37,000 customers on 6 April 2018. One notable benefit of early submission this year is that HMRC's late payment interest rate is at its highest level in c. 15 years, and due to rise still further (to 7%), meaning that early birds will reduce their chances of facing a punitive interest charge. ■

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- ▶ Cases: *HMRC v Third party and taxpayer* (7.2.23)
- ▶ Cases: *P Marano v HMRC* (6.6.23)
- ▶ Judicial review: does the Court of Appeal's decision in *Murphy* offer taxpayers a glimmer of hope? (A Craggs & L McKay, 7.6.23)
- ▶ Cases: *A Bhaur and others v Equity First Trustees (Nevis) Ltd and others* (30.5.23)