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DEPRECIATION AND TRADING STOCK – CONFUSION UNCONFOUNDED

by Barrie Akin

Accounting principles are not static - they have a tendency (rather akin to tax legislation) towards ever greater sophistication. But it is clear from the progress of *HMRC v. William Grant & Sons Distillers Ltd* and *Small (HMIT) v. Mars UK Ltd* through the Courts that judges and accounts do not mix well, even when the accounting issues are not particularly sophisticated. Fortunately, the fog of confusion that these cases have created in their passage through the Courts has finally been dispersed by the House of Lords[1].

The essential facts in both cases were straightforward. Part of the taxpayers' fixed asset depreciation was attributed to trading stock, as UK GAAP requires,[2] with accounting entries being made so as to ensure that the amount of annual fixed asset depreciation that was properly attributable to stock remaining unsold at the year-end ("Closing Stock") was taken out of the profit and loss account and added to the carrying value of Closing Stock in the companies' balance sheets. It was common ground that the two companies' accounts were drawn up in accordance with generally accepted accounting principles and complied with the provisions of the Companies Acts.

In their tax returns, the companies added back the net amount of depreciation that remained charged in their profit and loss accounts (i.e. excluding the amount

that was attributable to Closing Stock) under the usual disallowance provision in s. 74(1)(f) Income and Corporation Taxes Act 1988. That provision says that, in computing the amount of the profits to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of:

> " …any sum employed or intended to be employed as capital in the trade…"

HMRC took the view that it was not sufficient that the net depreciation charge should be added back. They took the view that the amount of depreciation that had been removed from profit and loss and added to the carrying value of Closing Stock should also be brought into charge to tax. From an accountant's perspective, HMRC's approach looks odd. The disputed amount had not reduced the companies' accounting profit in the year in question – it appears in the balance sheet in the form of an increased cost of stock and if the stock is sold in a subsequent period, this amount will be treated as depreciation (and disallowed for tax accordingly, under s.74). Thus, the full amount of depreciation will have been taken into account in the periods to which it relates and disallowed in such periods. So why should it be the subject of an add back under s. 74(1)(f)? Surely, there is nothing to add back.

The judges did not (in the main) find the issue easy to decide. Indeed, there is every indication that some struggled to understand what was going on at all. Some also fell into the trap of seeking to expound or explain how companies account for stock in trade when it might

have been more prudent to accept the undisputed accounting evidence.

When both cases came before the Special Commissioners[3], the companies' appeals were successful, but the Special Commissioners were troubled by the apparent discrepancy between the amount of depreciation that the Companies Act[4] requires to be taken into account in recording fixed asset values in the balance sheet and the net amount actually charged in the profit and loss account. This led them to give two reasons for allowing the companies' appeals. First, that only the net amount of depreciation had been deducted in the companies' profit and loss accounts, so that only that amount needed to be added back under s. 74(1)(f). Alternatively, they held that the depreciation excluded from the profit and loss account in respect of depreciation allocated to Closing Stock was not, for Companies Act reasons, acceptable as a deduction, so that the gross amount of depreciation charged to the profit and loss account (and not just the net amount) became disallowable. Nevertheless, an equal and opposite deduction (i.e. equal to the depreciation allocated to Closing Stock) should then be made in computing trading profit for taxation purposes so as to prevent the amount of depreciation[5] included in Closing Stock from being charged to tax as income. That alternative point, which was not actually argued before the Special Commissioners, was expressed to be the preferred reason for their decision. The problem faced by the Special Commissioner was, how to characterise the disputed amount. If the Companies Act required the

whole of the deprecation to be taken into account, then the disputed amount appeared to be in the nature of a capital profit. If this analysis were correct, one would then have to face the question, how this "profit" was to be dealt with in the subsequent accounting period in which the stock is sold.

HMRC appealed against the Special Commissioners' decision. The *Mars* appeal was heard by Lightman J in the High Court. The *William Grant* appeal was heard by the Inner House of the Court of Session. Both appeals were successful. In *Mars*, Lightman J[6] held that the company had deducted the whole amount of its depreciation in the profit and loss account (some £41m) and that the transfer from profit and loss of some £3m as depreciation relating to Closing Stock (which was then added to closing stock) did not alter the character of the £3m as depreciation or disapply s. 74(1)(f) in respect of it. He went on to disagree with the Special Commissioners' view that only the net figure (some £38m) was deducted in the profit and loss account. He considered that the agreed evidence did not establish that the deduction of the net figure was in accordance with generally accepted accounting practice, but took the view that the evidence established that the full sum of £41m had been deducted but that the *effect* of the credit of £3m was that only the net sum was deducted. He accordingly considered that the £3m was disallowable under the provisions of s. 74(1)(f).

With all due respect to Lightman J, this approach is misguided. The learned judge fastened onto to words of

the expert witnesses who gave evidence before the Special Commissioners[7] (in fact, it is clear that they did not agree on this point) and decided that the correct accounting approach was to regard the full amount of depreciation as having been charged to profit and loss. In saying that the credit to profit and loss that removed the element of depreciation relating to Closing Stock did not alter the character of the amount charged, Lightman J was clearly taking the view that s. 74(1)(f) overrode accounting principles in that respect. That cannot be disputed. But the statute does not say how one should decide what the actual charge for depreciation might be. Lightman J seems to have placed importance on the mechanism adopted in charging depreciation to the exclusion of the result. The objective of accounting is to arrive at a profit or loss for the accounting period which properly reflects the economic result for that period. The precise way in which this is achieved in any period (which will frequently include *bookkeeping* adjustments at or after the year-end) will vary. There is often more than one way to make the individual bookkeeping entries. Deciding on the quantum of depreciation by reference to the way the company did its bookkeeping is, it is submitted, to prefer form over substance in an area where it is substance that is key. Accounting entries need not reflect individual transactions. They frequently adjust the accounts in order to reflect the correct economic outcome. It cannot be right to fasten on the mechanics of the bookkeeping entries and to ignore the true picture. In *Gallagher v. Jones* [1993] STC 537, Bingham MR said, at page 555:

> "... I find it hard to understand how any judge-made rule could override the application of a generally accepted rule of commercial accountancy which (a) applied to the situation in question, (b) was not one of two or more rules applicable to the situation in question, and (c) was not shown to be inconsistent with the true facts or otherwise inapt to determine the true profits or losses of the business."

It is also clear that Lightman J did not justify his conclusion by reference to the provisions of the Companies Acts as to how depreciation should be provided, a point which had troubled the Special Commissioners. Lightman J also disagreed with the Special Commissioners' alternative view that the effect of disallowing the £3m would be to tax a capital profit on the increased carrying value of Closing Stock. He took the view that Mars had turned the depreciation into income by adding it to trading stock. As with the Special Commissioners, it would appear that he misunderstood the effect of the company's accounting for depreciation in Closing Stock.

The *William Grant* appeal was heard by the Inner House of the Court of Session in 2005.[8] The leading judgment of the majority was delivered by Lord Penrose. It is difficult to follow and extremely difficult to précis. In paragraph 80 he says:

> "In my opinion, the amount of depreciation that falls to be taken into account for closing stock in expressing the carrying amount is the amount apportioned out of gross depreciation provision for the period. If that is done, there remains

> nothing in the name of depreciation in stock available to credit directly to the gross depreciation charge against revenue. The result is that there must be added back the whole depreciation computed for the accounting period. That is, the amount that falls within s. 74(1)(f) in respect of depreciation in accounts prepared under the Companies Act is the amount of depreciation that requires to be written off in terms of para 18 of Sch 4, whatever the application of that sum in or towards the indirect production costs of other assets, and in particular stock."

Lord Penrose accordingly took the view that the full amount of depreciation must be disallowed, even if it was not deducted in the profit and loss account. Lord Osborne agreed with Lord Penrose's judgment and added[9] that the inclusion of depreciation in Closing Stock, it ceased to be depreciation. He then said:

> "In my opinion, it follows from that state of affairs, that that portion of depreciation, along with the remainder, requires to be added back in the year in question, as part of the gross depreciation, in consequence of the provisions of s. 74(1)(f) of the 1988 Act."

It seems clear that Lord Osborne took the view that the gross amount of depreciation for Companies Act purposes should be regarded as included in profit and loss, even if part of it had, for all economic purposes, been removed from the profit and loss account.

The dissenting judgment of Lord Reed is, in contrast, a model of clarity.

> "... the purpose of s. 74(1)(f) ... is to ensure that, for the purposes of taxation, a company's profits are not reduced by any deduction in respect of capital employed in the business. Accordingly, to the extent that the company's reported profits have been reduced by any such deduction (including any deduction by reason of depreciation in the value of fixed assets), s. 74(1)(f) requires the deduction to be cancelled by adding back an equivalent amount.
>
> The whole of the provision for depreciation in the value of fixed assets made in a company's balance sheet in respect of a given year has to be added to its reported profits ... only if those profits have been reduced by deducting the whole of that provision. Whether that has occurred is a question of fact. If part of the depreciation provision has not been so deducted in the year in question, but has been carried forward to a subsequent year, then s. 74(1)(f) does not require it to be 'added back'"

Both taxpayers appealed to the House of Lords[10]. The appeals were successful. The leading speech was given by Lord Hoffman, who made it clear that he considered the question to be how much depreciation had been deducted. He then went through the facts and said[11]

> "... I should have thought it was plain and obvious that, as only [the net amount of depreciation] has been deducted, s. 74(1)(f) does not require [the depreciation attributable to Closing Stock] to be added back."

He went on to dismiss HMRC's contentions to the effect that the accounting treatment adopted by the companies did not accord with fundamental principles of accounting and that paragraph 18 of Schedule 4, Companies Act 1985 required the gross amount of depreciation to be charged to profit and loss. The House of Lords decision is a victory for common sense. The effect of the decisions in the High Court and the Court of Session was that expenditure that would be deducted in future years was disallowed immediately. No convincing justification for such an arbitrary result was offered by the lower Courts. It is also worrying that judges still feel able to produce judgments that analyse accounting in detail, often going beyond the expert evidence. This is very noticeable in the judgment of Lord Penrose, which is frequently obscure, but others are also not without blame here. At least, none went as far as Lord Millett in *Commissioner of Inland Revenue v. Secan Ltd* 74 TC 1 in the Hong Kong Court of Final Appeal. His statements (among others) that

> "..the amount or value of an asset is a credit on the asset side of the balance sheet.."

and

> "...the cost of ... purchases (the debit) is normally matched by the increase in the value of stock (the credit) ..."

simply cannot have come from the accountancy experts who gave evidence in that case. Many non-accountants are perplexed by the expressions "credit" and "debit", being accustomed to meet them in the context of a bank

statement. Bank statements are extracts of the bank's books, and are therefore the mirror-image of the depositor's position. Perhaps Bingham MR's dictum (above) that judge-made rules should not in general override accounting principles should be extended – judges should not seek to explain the working of accounting unless they are *very* sure of their ground.

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[1] [2007] STC 680 (HL)
[2] See now FRS 15
[3] They were heard together: [2004] STC(SCD) 253
[4] Paragraph 18 of Schedule 4
[5] What the Special Commissioner referred to as the "capital amount".
[6] [2005] STC 958. The case bypassed the Court of Appeal under the "leap frog" provisions of the Administration of Justice Act 1969
[7] See para 16 of the judgment
[8] Reported in [2006] STC 69
[9] Para 98
[10] They were heard together: [2007] STC 680
[11] Para 13

"BENEFIT": A NOTE

by Milton Grundy

Whether a non-domiciled individual who receives outside the United Kingdom a benefit in the form of a transfer of money or of a chattel and later remits that money or chattel to the United Kingdom is chargeable to tax under ss.731 et seq of the Income Tax Act 2007 (s.740 of ICTA 1988) has caused some controversy. Michael Flesch QC, in an article in this *Review*[1] says he is not. "Just as", he says, "one cannot step into the same river twice, so too one cannot receive the same benefit more than once". James Kessler QC, in his *Taxation of Foreign Domiciliaries*[2] disagrees. He suggests that the "benefit" is not the *transfer*; it is the *asset* transferred. And that can be received a second time. He says that the statutory wording now in s.735(2) of ITA 2007 – "the benefit is not received in the United Kingdom" is comparable to (and based on) "the sums received in the United Kingdom" now in s.832(1) of ITTOIA 2005, and since it is clear (as indeed it is) that the latter words cover a sum received twice, the former words – if I have understood his argument correctly – contemplate that a benefit can be received a second time.

I have arrived at Michael Flesch's conclusion down a slightly different path. I may loosely say that a free lunch is a benefit. But it is not the lunch which is a benefit; it is its free availability to me. In general terms, a benefit is not a thing – a sum or a chattel; it is a relationship between a thing and a person. The establishment of this relationship requires the consent of

that person: you cannot confer a benefit on me without my consent. When I say that I "received" a benefit, I mean that I consented to the establishment of this relationship. The reason I cannot "receive" that benefit a second time is that I cannot consent to something to which I have already consented.

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[1] *GITC Review Vol.1 No.2 page 16.*
[2] 3rd Edition, Key Haven Publications Plc, paragraph 13.28.1.

ABUSE OF RIGHTS II – *WHA*: THE ELEPHANT ON CLOSER INSPECTION

by Hui Ling McCarthy

In the previous edition of this Review[1], I discussed the doctrine of abuse of rights and its application to the VAT regime, following the ruling of the European Court of Justice in *Halifax*[2], in which the court set out its two-stage test for determining whether abuse existed[3]. In certain respects, the ruling created more questions than it answered – the recent reference in *Part Service* (C-425/06) is a perfect example: the Italian Supreme Court requesting clarification on what, exactly, the European Court of Justice meant by “essential” aim. The Halifax ruling also caused a great deal of uncertainty as to how the doctrine would be applied by national courts. To this end, we waited with bated breath for the Court of Appeal’s judgment in *WHA Ltd and Another v HM Revenue & Customs*[4], the first indication of the higher courts’ approach to the question of abuse post-*Halifax*. Released on 17 July 2007, the judgment has generated much excitement (well, excitement for HMRC at any rate and a somewhat more tempered emotion for the rest of us). Although the abuse principle is beginning to take shape, certain areas of the Court of Appeal’s analysis in *WHA* are highly unsatisfactory. So far as prospective VAT planning arrangements are concerned, I would suggest that, although *WHA* might have spelt the end for purely artificial VAT avoidance schemes, planning to minimise VAT is, in itself, most certainly not yet dead.

The Arrangements in WHA

The arrangements at the heart of the appeal purported to have the effect of minimising overall liability to VAT in the context of the supply of repairs and parts, provided pursuant to contracts of motor breakdown insurance (MBI). Insurers would not normally be able to recover VAT charged on vehicle repairs, either because the supply of the repair works would be made to the insured rather than the insurer, or because repairs would be undertaken in the course of making an exempt supply of insurance to the insured. Accordingly, the purpose of the arrangements was twofold: (i) to ensure that the supply of repair services was made to the insurer, yet (ii) in such a manner that they would not comprise transactions made in the course of exempt supplies of insurance. The arrangements involved the reinsurance of a proportion of the liabilities via two Gibraltar-based companies as follows:

- An English company (NIG) issued MBI policies to members of the public.

- NIG reinsured 100% of its liability under the policies with a Gibraltar-based company called Crystal.

- Crystal in turn retroceded 85% of the reinsurance to another Gibraltar-based company, Viscount.

- Viscount contracted with an English company, WHA, to instruct garages to carry out repair works required to be effected under the policies

and to pay for those works. On each occasion, the garage responsible for carrying out the works rendered an invoice to WHA, who then rendered an invoice to Viscount.

WHA, Viscount and Crystal formed part of the same group of companies. The claims handling and contracts with the garages for repair works were subcontracted along the chain of companies from (originally) NIG to Crystal to Viscount and finally to WHA.

It was common ground that VAT was payable on the invoice rendered by the garage to WHA. The question was whether, at that stage, WHA was able to treat that VAT as input tax. WHA further contended that the invoice it rendered to Viscount was exempt from VAT with the result that WHA would be able to claim a repayment from HMRC of the input tax (because Article 17(3) of the Sixth Directive in part provided that Member States should grant every taxable person the right to a deduction of VAT in respect of any transactions exempted as insurance transactions when the customer was established outside the European Union for VAT purposes. Although part of the European Union – having joined the European Economic Community with the UK in 1973 - Gibraltar is based outside the Customs Union and VAT Area). Alternatively, if WHA was wrong and VAT was chargeable on its invoice to Viscount, then Viscount contended that it would be able to recover as input tax the VAT it incurred in respect of the invoice from WHA (again on the basis of Article 17(3)).

The history of the case before the Court of Appeal

A preliminary hearing took place in 2004 where the companies argued that, assuming the arrangements should be accepted at face value, each element of the scheme was technically correct. The Court of Appeal's interim judgment was released on 14 May 2004 and dealt with the non-abuse issues[5]. On a purely technical analysis, the Court of Appeal found that the arrangements *did* succeed in minimising the overall liability to VAT (in part, because of an inconsistency in the transposition of a particular Community provision into UK law – more on this later). Viscount was entitled to recover as input tax the VAT it paid to WHA (although the court determined that WHA was not entitled to recover the input tax it paid to the garages, on the basis that it had failed to establish that it did not make taxable supplies of services to Viscount).

The held-over part of the appeal concerned the application of the abuse of rights principle, pending the ECJ's ruling in *Halifax*. Lord Neuberger of Abbotsbury delivered the leading judgment with which Lord Justice Latham and Lord Justice Walker concurred without further comment. In September, the companies lodged a petition with the House of Lords for leave to appeal the abuse point, having been refused by the Court of Appeal. In between the two hearings, Lord Neuberger was appointed to the House of Lords (returning temporarily to the Court of Appeal to sit for the second hearing on 20 and 21 June earlier in the year). Bearing this in mind, it

will be interesting to see whether permission to appeal to the House of Lords will be granted.

The Court of Appeal's Finding of Abuse

In reaching its conclusion, the Court examined four questions:

1. Was the tax advantage sought "contrary to the purpose" of the provisions of the Sixth Directive?

2. If so, was the "essential aim" of the transactions to obtain a tax advantage?

3. If so, were there any special features that should prevent the principle of abuse from applying?

4. If the principle of abuse did apply, must (and if so, how must) the transactions be redefined?

On the question of abuse, broadly speaking the Court of Appeal held that, although each step of the scheme worked, its overall effect was unacceptable and contrary to the purpose of the Sixth Directive. When evaluating the question of abuse, the transactions had to be examined collectively, not individually. Furthermore, various elements of the scheme were "commercially pointless". Any reasons for entering into the arrangement other than the purpose of avoiding overall liability to VAT were so minor and unimportant that it could be said that tax avoidance was the "sole purpose" or "essential aim" of both the scheme as a whole and, more precisely, the involvement of Viscount. The Court considered that,

having satisfied both limbs of the *Halifax* test, *WHA* had not advanced any other convincing reason as to why the VAT advantage should nevertheless be allowed. The final twist in the Court's conclusion was that, contrary to previous belief, once a determination of abuse had been reached, it was *not* necessary to settle on a redefinition of the transactions in order to establish the VAT consequences: it was sufficient simply to deny the VAT advantage so claimed without having to reconfigure the arrangements as a preliminary step.

Before discussing the judgment in further detail, I should say that, on the whole, I find the Court's observations in respect of the "contrary to purpose" test helpful. Combined with the VAT tribunal's recent decision in *Weald Leasing*[6], it is also becoming clearer what part "artificiality" plays in finding abuse. However, I find unhelpful the Court's focus on the companies *change in business practice* when determining the "essential aim" of the arrangements. Moreover, the Court's conclusions on, in particular, the extension of the abuse principle to domestic legislation (albeit limited) and the question of redefinition are, to my mind at least, unsatisfactory.

Contrary to purpose (the first limb of *Halifax*)

In determining whether the resulting tax advantage was contrary to the purpose of the Sixth Directive, the Court of Appeal held that the scheme as a whole must be considered and not simply each component separately. This is, in my view, undoubtedly correct: the principle of abuse is an over-arching principle of interpretation – it

examines whether the overall result of an arrangement is acceptable in the context of the provisions of the Sixth Directive, notwithstanding that each individual element might work.

Reference was made to the ruling of the European Court of Justice in *Elida Gibbs*[7] in order to determine the purpose of the VAT provisions with which *WHA* was concerned, namely that the "basic principle of the VAT system is that it is intended only to tax the final consumer" and that "within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain". Accordingly, the Court accepted HMRC's argument that "fiscal neutrality requires the conclusion that an insurer, who provides, in the EU, insurance services which are exempt for VAT purposes, cannot recover input tax attributable to those services."

In the context of the normal commercial operations of an insurer and a claims handler within the EU, input tax attributable to the cost of the repairs and parts would be irrecoverable. In this instance, the provision of services comprising the claims handling (from WHA to NIG – both suppliers of exempt services) and the supply of repairs and parts (to WHA) were provided in the European Union. This was so, irrespective of the involvement of the two Gibraltar-based companies: the only commercial service provided outside the European Union for VAT purposes was the reinsurance. Accordingly, to the extent that the scheme in question had the effect of making recoverable input tax incurred

in the provision of exempt insurance services, the Court held that was contrary to the purposes of the Sixth Directive and the implementing domestic legislation. These commercial operations would ordinarily have resulted in an overall liability to VAT equal to the tax chargeable on the services and not, as resulted from the arrangements, no net liability to VAT whatsoever.

Artificiality and the contrary to purpose Test

My initial feeling was that the Court had construed the "contrary to purpose" test too broadly. Can it really be said that if an insurer, who provides in the European Union insurance services which are exempt for VAT purposes, attempts to recover input tax attributable to those services, he will always be acting contrary to the purpose of the Sixth Directive, whatever the circumstances – notwithstanding that the insurer might be acting to the letter of the Directive and may simply be taking advantage of a lacuna in the provisions by means of entirely genuine arrangements? On reflection, I do believe that this first limb of *Halifax* is as straightforward as that. The Advocate General in *Halifax* determined that the purpose and objectives of the Community rules were to be compared with the purpose and results achieved by the activity at issue. Therefore, where the purpose of the Community rules is that VAT should be non-recoverable, but the net result of an arrangement is the recovery of VAT, there is a conflict. The result is that the first limb is satisfied, even if the arrangements themselves are not artificial. So, an *absence* of artificiality is not sufficient to prevent

arrangements from being contrary to the purpose of the Sixth Directive.

In my view artificiality has its place in the contrary to purpose test as follows: whereas on the one hand the absence of artificiality will not save a scheme from being contrary to the purpose of Community law, on the other hand, the *existence* of artificiality will bring a scheme within the confines of the first limb where otherwise it may not have been. Take, for example, the VAT tribunal's decision in *Weald Leasing*[8]: nothing in the Sixth Directive (either expressly or by implication) showed that an exempt trader may not defer or spread the burden of input tax by leasing (accordingly, a commercial decision to lease rather than to purchase outright would not, on its own, be contrary to the purpose of the Sixth Directive). However, artificially suppressed rents *would have* resulted in a tax advantage contrary to the purpose of the directive.

An *absence* of artificiality is therefore only material in connection with the essential aim test, so far as VAT is concerned. This is predominantly where the analysis in direct tax cases on abuse (such as *Cadbury Schweppes*[9]) becomes relevant to VAT.

Essential Aim (the second limb of *Halifax*)

The Court of Appeal proceeded on the basis that establishing "the essential aim of the transactions concerned" was not substantially different from the "sole purpose" test also envisaged by the European Court of Justice in *Halifax* and was content to leave to another

day the debate as to whether the former could conceivably be a looser requirement.

Revisiting the findings of the VAT tribunal, the Court agreed with HMRC that, judged objectively, the purpose of the transactions (in particular the imposition of the two Gibraltar-based companies) had been to obtain a tax advantage, namely the recovery of input VAT paid by WHA to avoid a net liability to VAT. The Court considered that the minutes of various meetings between Crystal and Viscount, as well as the fact that all companies involved in the arrangements were 100% members of the same group, were relevant objective factors in determining the essential aim of the transactions. Even assuming the conceivably stricter "sole purpose" test, the Court concluded that collateral or otherwise minor commercial benefits derived from adopting the arrangements could be ignored.

There is, however, a potential deficiency in the Court's analysis at this point (although perhaps not in its conclusion): in establishing the essential aim of the transactions, the Court's focus was very much on whether there was a commercial justification for the group's *change in business practice*, as opposed to a justification for the arrangements *standing alone*. However, the European Court of Justice's reference to a taxable person's "normal commercial operations" is to be assessed *objectively*. In other words, in my view the comparison is to be made between, in this case, the arrangements of the insurer who is the subject of the appeal and the "normal commercial operations" of

insurers collectively, and not between that particular insurer's operations before and after adopting the arrangements in question. It would make a nonsense of the test and lead to a potential distortion of competition if one trader was precluded from altering its commercial practice during the course of its business, but another could commence trading adopting the disputed practice from the outset. That a taxpayer's structuring of his supply is merely unusual or even abnormal is not sufficient for a finding of abuse.

The Court considered that, in one sense, the purpose of the arrangements was to enable NIG to perform and reinsure its liabilities. In my view, the fact that the group had not previously sought to reinsure its liabilities is not a sufficient reason *by itself* for rejecting this as a commercial justification. However, the VAT tribunal had previously found (and the Court of Appeal agreed) that, given the 100% ownership structure of the group, the reinsurance was itself of no real value, other than enabling WHA to reclaim input VAT. This is key: the group was not simply exercising its freedom to structure its business operations as it chose, because the relevant components (included to bring about the required VAT consequence) in fact formed no part of its genuine business activity at all. As the European Court of Justice confirmed in *Halifax*, the purely artificial nature of transactions may be taken into account when determining the essential aim. This is effectively where the *Cadbury Schweppes* analysis comes in – simply because a taxpayer might have an avowed purpose or intention of benefiting from a tax advantage, provided

that the arrangements comprise part of his genuine business activity, there should be no abuse, as the essential aim test is not met.

So far as the essential aim test is concerned, taxpayers are at something of a disadvantage from the outset. Although the test is supposedly determined objectively (theoretically ignoring a taxpayer's subjective intentions) this is incredibly difficult to do – especially if HMRC have obtained full disclosure from the taxpayer in advance of the hearing and, on the day, produce document after document, minute after minute detailing the potential VAT saving a change in business practice might achieve. If amongst those papers there is a brief mention of some other spurious commercial benefit to the new arrangements, this is hardly likely to alter a tribunal's perception in favour of the taxpayer.

To establish a genuine commercial purpose convincingly, evidence of the commercial *results* achieved by an arrangement is invaluable. For example, a tribunal might not attribute much weight to a set of minutes outlining a hypothetical financing benefit (other than a VAT saving) derived from a series of transactions yet to be implemented; but if these minutes were corroborated by documentary evidence of genuine commercial results actually achieved following implementation, the weight of this combined evidence would be far more powerful. A genuine financing benefit might result in, say, a reduction in bank borrowings the following year, which would be reflected in that year's annual accounts: these would provide the requisite

objective evidence of an essential aim other than the obtaining of a tax advantage.

Should HMRC's case on abuse otherwise fail?

Having concluded that the two limbs of the *Halifax* test had been satisfied, the Court of Appeal then considered a number of other arguments advanced on behalf of the companies as to why HMRC's case on abuse should otherwise fail; all of which were rejected.

(i) *A taxpayer's entitlement to minimise his liability to VAT.* The Court of Appeal drew a distinction between a taxpayer's reliance on wholly artificial and ingenious steps included purely to obtain a tax advantage (namely the insertion of Viscount and the claims handling chain) as opposed to his entitlement to choose the least-taxed route out of a number of options properly available to him.

(ii) *Legal certainty.* The Court of Appeal concluded that the need for legal certainty was not an additional hurdle for HMRC to overcome, once the *Halifax* test has been satisfied. Although not entirely clear from the Court's judgment, it appears that the companies advanced their argument on legal certainty on the basis of paragraph 72 of the ECJ's judgment in *Halifax* – where rules are liable to entail financial consequences, those concerned must know precisely the extent of the obligations imposed on them. However, in *Kofoed*[10], the European Court of Justice approached legal certainty in the

context of abuse from another direction, ruling that the principle precludes directives themselves from being able to create obligations for individuals and accordingly cannot be relied upon against individuals by Member States, without the necessary implementing legislation. As the doctrine of abuse is simply a principle of interpretation of Community law (it is certainly not a general anti-avoidance rule), it follows that it must need an applicable directive onto which to latch. I suggest that legal certainty *can*, therefore, represent an additional hurdle in cases (such as *WHA*) where the results of the transposition of Community law to domestic law are not sufficiently clear and precise, so do not afford the persons affected by them the opportunity to know the full extent of their rights and obligations; this point is developed in (v) below.

(iii) *Inconsistency between the technical analysis and the case for abuse*. Simply because, on a step-by-step analysis of the scheme, it had been established that WHA was obliged to charge output tax for the supplies it made to Viscount, the Court did not consider itself precluded from reaching a conclusion on the question of abuse that was inconsistent with that finding. The question of abuse required examining the effect of the scheme as a whole: the net tax advantage derived from the arrangements viewed collectively.

(iv) *The principle of freedom of establishment.* In this instance, the Court held that their finding of abuse did not offend against the principle of freedom of establishment because the group was not impermissibly penalised for exercising its freedom to set up Viscount in Gibraltar. Unlike in *Cadbury Schweppes*, it was not the establishing of Viscount in Gibraltar that was allegedly abusive, but the involvement of Viscount in the scheme that was the artificial contrivance. There is a danger, however, that HMRC may seek to generalise the Court's conclusion on this point too far. It is certainly not the case that conduct amounting to a legitimate exercise of freedom of establishment is an abuse of the provisions of the Sixth Directive, simply because the taxpayer concerned benefits from a more favourable VAT regime. There must still be an element of artificiality (as the ECJ ruled in *Cadbury Schweppes*) in amongst the arrangements. Either the establishment itself must be artificial in the sense that it is fictitious (*Cadbury Schweppes*) or the economic activities in which that establishment purportedly participates must be artificial in the sense that they are "commercially pointless" (*WHA*).

(v) *Reliance on domestic (as opposed to Community) legislation.* The Court of Appeal rejected the companies' argument that because the success of the scheme depended on provisions of domestic rather than Community law, the doctrine of abuse

(as a principle of Community law) could not apply. The Court acknowledged that Viscount was able to recover input tax paid by WHA, not because of the provisions of the Sixth Directive[11] or the Thirteenth Directive, but only because of provisions of national law[12] which imperfectly transposed the Directives. However, it went on to determine that the domestic legislation in question had been enacted with the *intention* to give effect to the provisions of the Directives and that was sufficient for the principle of abuse to encompass the relevant domestic provisions. In my view, this conclusion is highly unsatisfactory. In its preliminary judgment concerning the technical merits of the arrangements, the Court of Appeal concluded that domestic legislation went *further than is envisaged by the Sixth Directive* in permitting persons based outside the Community to reclaim VAT, so that Viscount could rely on a specific provision of domestic law in order to recover the input tax it paid to WHA. Herein lies the problem: following Halifax, it is quite clear that the doctrine of abuse governs *the interpretation of Community law*[13] - once again, it is not a GAAR. Accordingly, where the Court is *not* required to interpret Community law, it is difficult to see on what basis the abuse principle can apply. It is trite law that, just as directives do not have horizontal effect, in addition, they do not have direct effect against individuals (in this case, the taxpayers, as set out in (ii) above)[14]. Accordingly, the principle of direct effect surely

cannot cure the incorrect transposition of Community law here. One option open to the Court would have been to impose a "directive-compliant" interpretation of national law on the companies[15]. However, the Court of Appeal expressly disclaimed this option at paragraph 142 of their preliminary judgment. It would be highly contradictory to attempt to reinstate it here. Unlike various other Member States (for example, Greece), the UK has not enacted its own national provisions prohibiting abuse. Furthermore, the doctrine is not recognised as part of the UK's notion of purposive construction and no domestic anti-avoidance principles exist to cure similar defects in domestic legislation (as demonstrated by Lord Hoffman's speech in *MacNiven (Inspector of Taxes) v. Westmoreland Investments Ltd*[16] and more recently by Henderson J's observation in *HMRC v D'Arcy*[17]). In the absence of a provision or general principle prohibiting abuse *in domestic law*, an extension of the Community law principle of abuse is unjustified[18]. Put simply, so far as the UK is concerned, it cannot be said to be an abuse of Community law to take advantage of a domestic loophole – however 'well-intended' the Parliamentary draftsman's efforts to correctly enact the equivalent domestic provision[19]. In my view, the fact that the abusive nature of a particular scheme should be determined by considering the scheme as a whole does not save the analysis: how can it be said that a taxpayer

has improperly or fraudulently taken advantage of provisions of Community law if domestic law (namely Regulations 186 and 190 of the Value Added Tax Regulations 1995, SI 1999/3121) in part permits him to do so?

(vi) *The doctrine of abuse should not be invoked to put right an oversight in the drafting of national legislature*. The Court of Appeal considered that (although essentially a permutation of the companies' fifth argument) there was some merit in this point. Nevertheless, they rejected it for the same reasons. However, the ECJ's ruling in *Kofoed* suggests that the Community doctrine of abuse cannot be extended to correct such domestic defects in the absence of an equivalent national anti-abuse measure. It will be interesting to see whether the House of Lords grants the companies permission to appeal, given that the ruling in *Kofoed* was released on 5 July 2007 – post-dating the hearing on the question of abuse in *WHA*, but preceding the release of the Court of Appeal's judgment.

(vii) *The genuineness of the individual steps comprising the scheme*. The fact that the tribunal found that each individual step comprising the scheme was a genuine transaction did not preclude a finding of abuse: the Court of Appeal held that this was entirely consistent with the ECJ's ruling in *Halifax* where the fact that a transaction was entered into for the purposes of

tax avoidance did not prevent it from being a genuine supply for VAT purposes. Such transactions, although genuine, were nevertheless outside the range of the companies' normal commercial operations.

(viii) *Subjective motive*. The fact that the subjective motive of the parties to the scheme was irrelevant did not assist the companies in this case: the inclusion of Viscount as a retrocedent (given the tribunal's conclusion that this was "commercially pointless") coupled with the claims handling chain were objective factors demonstrating that the essential aim of the transactions was to minimise overall liability to VAT.

(ix) *Minimising liability to Insurance Premium Tax (IPT)*. Finally, the Court dismissed the companies' purported justification that the arrangement was necessary in order for the group to compete with traders established outside the European Union following the introduction of IPT. Increasing profits or avoiding or reducing loss was not by itself a sufficient commercial reason for defeating an abuse claim as that would always be the natural outcome of minimising liability to VAT.

Redefining the transactions

Another of the more surprising elements of the Court's judgment is its conclusion that it was not mandatory to redefine the series of transactions

following a finding of abuse. It was enough, or so the Court of Appeal held, simply to neutralise the effects of an abusive scheme merely by removing the purported VAT advantage, provided that the consequences of the scheme in question did not involve further rights of tax authorities to demand tax, rights of taxpayers being over-taxed or rights of any third parties. The Court of Appeal held that because the scheme in question did not compromise any such rights (as the tax due had been fully paid, but not overpaid, and no third party rights needed protection) redefinition had no purpose. As the scheme was abusive (albeit achieving its tax-saving aim at face-value) the outcome was simply that Viscount was not entitled to recover as input tax the VAT it incurred in respect of the invoice from WHA, and that was the end of the matter.

In *Halifax*, the European Court of Justice considered that "transactions involved in an abusive practice *must be redefined* so as to re-establish the situation that would have prevailed in the absence of the transactions constituting the abusive practice." To justify their conclusion that there was no need for redefinition, the Court of Appeal interpreted the mandatory term "*must be redefined*" to mean that the original, abusive transactions could not be permitted to remain, rather than that a counter-factual must be determined. So far as the Court was concerned, redefinition did not present a third hurdle to HMRC once the *Halifax* test had been satisfied. Superficially, this is an attractive conclusion to reach: if a practice is abusive in that it improperly takes advantage

of Community law, what could be simpler than removing the advantage, so remedying the abuse?

However, is the Court's conclusion (that the tax position was neutral as regarding the taxpayers', the tax authority's and any third party's rights, so that redefinition would serve no particular purpose) necessarily correct? HMRC's preferred analysis (and indeed the VAT tribunal's approach) was that the garage's supply should be treated as being made to the insured alone. In which case, a VAT registered insured would be able to reclaim the VAT on his bill from the garage. Albeit this redefinition does not confer a VAT advantage on the group (it would be, after all, the insured that would benefit from the VAT repayment), it nevertheless affects both the tax authority's and a third party's rights. Taking this a step further, what if (rather than paying the gross amount of the insured's bill) the insurer agreed with its VAT-registered customers that it would refund an amount net of VAT. Although the insurer's net VAT liability would itself remain unaltered, its net financial position would be as if it had been able to reclaim VAT in respect of its VAT-registered customers. Surely this business model falls within one of the options available to a trader?

By choosing to interpret the ECJ's ruling on redefinition as they did, the Court of Appeal has effectively managed to avoid a number of complicated questions that must surely arise in due course, the more the principle of abuse is litigated before the domestic courts. For example, if, following a finding of abuse,

there are two or more possible ways in which the abusive arrangements can be recharacterised, would it amount to a penalty not to redefine the transactions in the most tax-efficient manner (bearing in mind that the European Court of Justice in *Halifax* ruled that a finding of abuse must not lead to a penalty)? Is there to be a presumption that a taxpayer would always select the most tax-efficient option? In *Cantor Fitzgerald*[20], the European Court of Justice ruled that a taxable person with a choice between two transactions could not choose one of them and avail himself of the effects of the other. Although *Cantor Fitzgerald* concerned an entirely different issue, an indirect corollary of the judgment could be that simply denying a trader the most tax-efficient recharacterisation does not automatically equate to a penalty. But even if some readers are inclined to think that, given a choice between two recharacterisations, it is obvious that the most tax-efficient must be selected, how about this: what if there are two options for redefinition, both of which bring about the same VAT consequences for the trader, but one would give the trader a net financial advantage - which does the court choose then? Take HMRC's preferred analysis in the paragraph above, with the modification that the insurer refunds its VAT-registered customers an amount net of the VAT they incurred. The trader's net VAT liability remains unaltered, but not its net financial position, which varies inversely to the amount of output tax HMRC collects. So should HMRC's net VAT position be ignored?

Conclusion

Although the Court of Appeal's judgment in *WHA* appears to be, superficially at least, very bad news for VAT planning, it is not quite the case that "[t]he unanimous decision of the Court of Appeal gives clear answers to many of the questions being raised by taxpayers and their advisers in abuse cases", as Chris Tailby, the Director of HMRC's Anti-Avoidance Group, wrote in a recent article for Tax Journal[21] (if one assumes that "Will it work?" and "No" are respectively the genre of questions and clear answers Chris Tailby had in mind). As already mentioned, it should be remembered that the VAT tribunal in *WHA* made a number of damaging findings of fact regarding artificiality. I would suggest that, although a powerful weapon against contrived VAT avoidance schemes, there are still generous opportunities to argue that *WHA* can be distinguished in cases on different facts.

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[1] *Abuse of Rights – Europe's Legal Elephant*, GITC Review, June 2007

[2] *Halifax v Customs and Excise Commissioners* (C-255/02) [2006] STC 919

[3] At paragraph 86 of the ECJ's judgment in *Halifax:* "… first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. … the prohibition of abuse is not relevant where the economic activity

carried out may have some explanation other than the mere attainment of tax advantages."

[4] [2007] EWCA Civ 278

[5] [2004] EWCA Civ 559

[6] V20003 Weald Leasing Limited, VAT Tribunal Decision.

[7] *Elida Gibbs Ltd v Commissioners of Customs and Excise (Case C-317/94)* [1996] STC 1387

[8] At paragraphs 135, 136, 142 and 146 of the decision.

[9] *Cadbury Schweppes plc v Inland Revenue Commissioners (Case C-196/04),* [2006] STC 1908

[10] *Case C-321/05 Kofoed v Skatteminsteriet*, released on 5 July 2007

[11] Namely Articles 9(2)(e) and 17(3).

[12] Namely Regulations 186 and 190 of the Value Added Tax Regulations 1995, SI 1999/3121.

[13] As the Advocate General expressly stated in his opinion and the Commission stated in its written observations in the *Halifax* case (at paragraph 69).

[14] As this would "totally blur the distinction between regulations and directives which the Treaty establishes in Articles 189 and 191", per Advocate General Slynn in *Case C152/84 Marshall v Southampton and South-West Hampshire Area Health Authority (Teaching)* [1986] ECR 723 at 734. See also *Kofoed*, ECJ at para 42 and teh VAT tribunal's observation in *Weald Leasing* at paragraph 154 that Member States cannot rely on direct effect but must transpose the provisions by domestic legislation. Although contrast this with the position that individuals *can* rely on incorrectly implemented directives against the State, provided that the directive is sufficiently clear and precise (see, for example, Case C-62/00 *Marks & Spencer v C & E Comrs* ECJ, para 25).

[15] As suggested by the ECJ in *Kofoed* at para 45.

[16] [2001] 1 All ER 865 at 884 when he repeated what had been said of a direct taxing statute in *Norglen Limited v Reeds Rains Prudential Limited* [1999] 2 AC 1 at 14, "It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes."

[17] [2007] EWHC 163 (Ch), para 47, to the effect that unintended gaps occur in a tax system as complicated as that of the UK – well-advised taxpayers are not precluded from taking advantage of them.

[18] It would appear that the ECJ is clear on this point – see *Kofoed* at paragraph 46

[19] Of course, all this may well be academic, if indeed, as the European Commission considers, the Sixth Directive had actually been correctly transposed after all – see para 48 of the Court of Appeal's judgment.

[20] Case 108/99 *CC&E v Cantor Fitzgerald International* [2001] ECR I-7257, ECJ. The ECJ ruled that, although the subletting of property by a tenant for a lower rent or the payment of compensation to the landlord for early termination of a lease (both exempt transactions) would have been comparable in economic impact to the assignment of the original lease for a fee payable by the original tenant, it did not follow that the assignment should have the same VAT treatment.

[21] *Abuse: WHA Decision Released*, Tax Journal, Issue 896, 7, 30 July 2007.

THE UNITED KINGDOM AS AN OFFSHORE CENTRE

by Aparna Nathan

The title may come as a surprise to some readers. The perception is that the United Kingdom has high taxes. However, in reality, first, the rates of tax are competitive and, second, the UK tax system has itself carved out a beneficial system for non-residents which permits them to make use of UK situate service providers without falling into the UK tax net. The top rate of income tax for UK residents or non-residents with UK source income is 40%. Further, following a recent announcement by the Chancellor, the top rate of capital gains tax is limited to a flat rate of 18%. However, non-residents are not chargeable to capital gains tax even if the assets disposed of are situated in the United Kingdom. Resident corporates are liable to corporation tax at a rate of 30% (with small companies liable to tax at a 19%). Non-residents are liable to tax on UK source income and on gains realised by a permanent establishment in the UK through which they carry on a trade in the UK. Finally, inheritance tax is chargeable at a rate of 40% on death transfers (20% on certain lifetime transfers) on all assets other than excluded property. In effect, non-residents who are non-domiciled are not liable to inheritance tax on foreign situate assets and certain UK situate assets e.g. Government securities.

Non-residents are in a favourable position in relation to UK partnerships. The United Kingdom has three types of partnerships: general partnerships, limited

partnerships and limited liability partnerships (introduced by the Limited Liability Partnerships Act 2000). The limited liability partnership limits the liability of each partner in respect of the acts and omissions of the other partners. Partnerships are regarded as transparent for most tax purposes: unlike companies, they are not taxable entities, and it is irrelevant for the purposes of the taxation of partnerships where the central control and management of a partnership is exercised. Non-resident partners are not liable to UK income tax on foreign-source income. It should be noted that the profits of any trade carried on by the partnership in the United Kingdom will have a UK source.

Further, the UK offers a highly favourable tax regime for trusts made by settlors who are non-resident, not ordinarily resident and non-domiciled and which have at least one trustee who is not resident in the United Kingdom, even though the other trustee or trustees are resident. Foreign income and any gains arising to the trust (including gains arising on a disposal of UK-situate assets) are not chargeable to tax. Further, non-resident beneficiaries will not be chargeable to income tax or capital gains tax on distributions from such trusts.

UK resident companies also have their uses. For instance, a company (the parent) situated in a traditional tax haven may wish to set up a UK resident subsidiary company which acts as its agent in making sales to third parties who may not wish to be seen to trade with companies situated in traditional tax havens. Provided that the sales contracts are not made in the United

Kingdom, the UK company will pay tax on its agency fees (ascertained on an arm's length basis) and the trading profits of the parent will not be chargeable to UK tax.

The United Kingdom does not levy tax on outgoing dividends, and accordingly a UK company can sometimes be used to advantage in reducing the exposure to tax on distributed profits of a foreign company. For example, a UK company, which is the holding company of an operating company situated in another territory may, as a result of the relevant double tax agreement or under the Parent/Subsidiary Directive, receive dividends from the operating company free of, or at a reduced rate of, withholding tax. It may be entitled (by way of unilateral relief or treaty relief) to credit for such withholding tax and the underlying tax on the profits out of which the dividends are declared. If this amounts to 30% (the rate of UK corporation tax), there will be no UK tax to pay. The sale by the UK holding company of its holding in its trading subsidiaries, provided that the conditions for "substantial shareholding relief" are met, will be exempt from tax. The United Kingdom has an extensive network of tax treaties to which UK resident companies have access.

The clear advantage of using the United Kingdom in any structure is that, quite apart from the favourable tax regime it offers non-residents, it does not feature on any blacklist and the presence of an entity situated in the United Kingdom will, generally, not prejudice foreign revenue authorities against the transaction or structure.

(Adapted from the author's contribution to *Offshore Business Centres* 8th edition, edited by Milton Grundy and the author, to be published by Sweet & Maxwell next year.)

RECENT TRENDS IN TAX LITIGATION

by Michael Thomas

Introduction

The purpose of this article[1] is to try and identify, with reference to some recent cases, the key themes of current UK direct tax litigation. It is hoped that the patterns which emerge can then be applied to help enable taxpayers to obtain favourable outcomes in disputes with HMRC. The best possible result, of course, is to avoid a dispute entirely, but this is not always possible. The article is in three parts. First, I shall look, in a very broad way, at how our tax system has been developing recently and consider the impact of this on tax litigation. The second part involves a more detailed look at some important direct tax cases from the last year which are relevant to small and medium sized enterprises (SMEs). Some of the cases also deal with points of substantive interest as well as illustrating the patterns of tax litigation. The final section attempts to pull the themes which have been identified together and suggests where future attacks from HMRC are likely to come and how they might successfully be avoided or, if necessary, defeated.

Recent Developments in the UK Tax System and Their Impact on Litigation

The key development in our tax system in recent years has been the exponential increase in the amount of legislation. The motivation for any tax reform is to raise

more money. Most of the legislation is designed to close what the Government perceives as loopholes and thereby increase revenues. The up-front cost to the Government from legislation is minimal and it avoids the need to litigate grey areas. HMRC's recent more aggressive stance towards schemes and the introduction of the disclosure rules in 2004 have seen the legislative process accelerated so that HMRC will change the law first and litigate afterwards (if they consider it worth their while). Hence in the last few years there has been a large amount of anti-avoidance legislation, including very specific amendments, and whole new regimes such as that dealing with "Pre-owned Assets", "Targetted Anti-Avoidance Rules" for capital gains tax and even a mini "General Anti-Avoidance Rule" for SDLT - the notorious s.75A. In addition the legislative rewrites have achieved little other than making the statute book even fatter and rendering textbooks out of date.

However, legislation comes at a cost. First, there is the price of complexity. The more complex the law is the, the more time and resources both taxpayers and HMRC have to spend ensuring that taxpayers have complied properly with their obligations. HMRC's general line is that complex anti-avoidance legislation is necessary to combat the ingenuity of tax planners and those who are not doing aggressive planning can safely ignore large swathes of the tax code. There is some truth in this, but many of the ordinary charging provisions, such as Schedule 22 ITEPA, are very complex and wide-ranging. Other regimes, notably the SDLT Schedules dealing with leases and partnerships, are

disproportionately complex relative to the tax at stake. This gives rise to the danger that issues are overlooked, which should be a serious concern for both taxpayers and HMRC. In turn, this increases the likelihood of increased tax-based fraud and negligence cases, which is not the kind of litigation any of us wants to be involved in. Finally, and ironically, complex technical legislation aimed at preventing tax planning tends to provide fertile ground for developing exactly the kind of tax schemes it is meant to prevent. That this last point is not lost on HMRC is demonstrated by the more innovative kinds of anti-avoidance legislation which have appeared recently.

Secondly, because law is an interpretive practice, every last statutory provision is open to dispute. Human activity is infinitely varied and no code can apply with absolute clarity to every situation. Increasing the amount of legislation thus actually increases the scope for litigation rather than the opposite. Frederick the Great famously discovered this when enacting the Prussian Civil Code. He had the enlightened idea that a suitably comprehensive code could prescribe an answer in every situation and thereby do away with the need for disputes and lawyers. Of course the idea failed, and the lawyers argued over the correct interpretation of the code! The lessons of history have not prevented those responsible for our tax code from repeating the pattern. Nor is legislation the answer to everything even for HMRC. UK legislation must comply with EU law. The Government cannot simply change the law when the relevant tax is VAT, and this, as well as the culture of the former HM Customs & Excise, has driven the high volume of VAT

litigation in recent years. The recent direct tax challenges based on the incompatibility of UK law with EU law, such as *Cadbury Schweppes*[2] on CFCs, have been brought precisely because the Government cannot achieve the result it wants by enacting UK law which breaches EU Law.

Finally, it is no use having anti-avoidance legislation as a deterrent if HMRC is not prepared to back it up by litigation. The reason for this is that it is (almost) always possible to find some kind of technical argument that aggressive planning works, and if it appears that HMRC is not likely to litigate then some clients will take a commercial decision to run the risk and attempt the planning. This is a legitimate course, provided that the taxpayer's self-assessment obligations are complied with, which will very likely mean making additional disclosures to HMRC. Accordingly, it is important, if HMRC wants to stop what it considers unacceptable tax planning, that it actually litigates the cases. Hence the statements made to this effect especially by Dave Hartnett at the 2005 Latimer Conference and the challenges to aggressive schemes which HMRC is now bringing through the courts. It should be noted, however, that by no means have all the schemes which were blocked by legislation in recent years been challenged.

Review of Direct Tax Cases Relevant to SMEs

A general distinction can be drawn between two kinds of tax case. One kind is where there has been what might (neutrally) be labelled as an "aggressive self-

assessment", and this might raise a point of fundamental importance, depending on how common the situation is and the significance of the relevant statutory provision. The other is where HMRC challenges a scheme. There are other kinds of cases which fill up the reports, but these are outside the scope of this article. VAT litigation and direct tax challenges based on EU law have been referred to above. One species of case which deserves a mention in passing is those based on HMRC's information powers. When HMRC seeks information from taxpayer then it almost invariably wins any contested hearing. It will therefore generally be detrimental to try and withhold information because to do so will only heighten their curiosity and merely delay the inevitable at the cost of antagonising and arousing the suspicions of HMRC.

I now want to consider some important recent tax cases, mostly from the last year. For present purposes, I am chiefly concerned with what the cases tell us about the challenges which HMRC brings and how the courts dispose of them. It is important to remember that both HMRC and the judges, by which term I include the Special Commissioners, are human beings. The judge's job is to try and find the right result by applying the law, with due regard to its purpose, to the facts. In the words of Ribeiro PJ[3] the "ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically." Judges do not approach the case in blinkers. It therefore greatly assists a litigant to be able to demonstrate that he has merit on his side.

Challenges to Schemes

In contrast, when a judge decides that the participants in a tax saving scheme are "acting out a charade", as Sir Stephen Oliver did in the recent case of *Drummond v. HMRC*[4], then there is only likely to be one result. In *Drummond,* the taxpayer entered into a scheme entered into a scheme designed to create a £2m allowable loss for CGT purposes. The taxpayer bought 5 second-hand 'non qualifying' life assurance policies for £2 million. The next day the policies were surrendered for £1.75 million. He then claimed a loss of £1.96 million. The key provision (and note that the scheme has since been countered by statute) was s.37(1) TCGA 1992. It provides that there is excluded from the CGT computation "money ... taken into account as a receipt in computing income or profits or gains ... or, the person making the disposal*.*" The taxpayer's case was that the entire surrender proceeds of the policy was taken account of in computing the "chargeable event gain" in Ch.II Part XIII ICTA, which was taxable as income, notwithstanding that in performing that calculation the total of the premiums paid was subtracted to leave only £1,351 actually chargeable. Sir Stephen Oliver found against the taxpayer and concluded that only the actual chargeable event gain of £1,357.35 was taken into account so as to be ignored under s.37(1). Having decided against the taxpayer on the s.37(1) issue Sir Stephen Oliver considered whether the £1.96 million was deductible in the CGT computation to give the taxpayer a £210,000 loss (which is the economic loss he had suffered). He found against the taxpayer on this

point also. Sir Stephen's decision on this point may have been coloured by his view of the scheme. The taxpayer and the promoter were quite frank in admitting that this was a tax avoidance scheme which sought to take advantage of an apparent statutory mismatch. This did not gain them much judicial sympathy. It is also noteworthy that the entire history of the strategy and its promotion is set out in the decision. For example, a letter from the promoter to the client outlining the strategy is reproduced in full.

Astall and Edwards v. HMRC[5] is a slightly different kind of case from *Drummond*. *Astall* concerned a scheme involving relevant discounted securities. The taxpayers settled small sums into a trust in which they had a life interest. The settlor then lent money to the trust in return for a security. The security provided that if a condition relating to the dollar-pound exchange rate, which was designed to have an 85% chance of being satisfied, was met within one month, and a notice to transfer the security was given, the purchaser could redeem it at 5% of the issue price on 7 days' notice, but otherwise the security became redeemable only after 65 years. The exchange rate condition was duly satisfied. The taxpayer then sold the security to a bank at a large loss, and the bank redeemed it at 5% of the redemption price. The taxpayer unsuccessfully tried to claim the loss on the difference between the issue price and the price received from the bank as a loss on a relevant discounted security under Sch.13 FA 96. *Scottish Provident* and *Barclays Mercantile* were applied so that a purposive construction was given to the definition of relevant

discounted security, and the facts considered with regard to the real possibilities of redemption. It was a practical certainty that the security would be redeemed at a loss of 94%. Accordingly, the security was not a relevant discounted security. This conclusion illustrates that the courts are prepared to construe purposively even technical legal concepts such as "relevant discounted security." It is noteworthy that again the Special Commissioner (Dr. J Avery Jones) went through the history of the scheme and the documentation which was issued. Having done so he found that the exchange condition and the fact that KPMG delayed seeking a purchaser until after the issue of the securities were inserted purely as anti-*Ramsay* devices.

The *Drummond* and *Astall* cases are only two of several in the last year where HMRC has successfully challenged schemes. Nevertheless, they amply demonstrate the crucial point that litigating against the state is always tough, and that trying to uphold an aggressive tax saving scheme is always going to be even tougher. It is no surprise whatsoever that HMRC has tended to succeed in its recent challenges against schemes. The key point is that, in the eyes of the judiciary, the taxpayers lacked merit. Taxpayers cannot expect judicial sympathy for clever technical arguments which produce loopholes, when there is a respectable alternative analysis which denies the loophole. It should also be borne in mind that the presence of a tax scheme means that, even if the arrangement achieves its immediate aim, the courts will be more receptive to an attack from HMRC on a separate point.[6]

The moral of the story seems to be clear: if a taxpayer does a scheme based on a loophole, then if at all possible it is much better to make sure it is a good one rather than one which is just technically arguable. It might perhaps be asked, what is a good scheme? Perhaps the best answer is that it is one where the loophole is not just technically arguable, but so clear that, even with the aid of *Ramsay*, HMRC cannot convince a judge that the statute is not flawed. An example of such a case is *HMRC v. Darcy*[7]. In *Darcy* the taxpayer entered into a series of transactions in gilts with the aim of obtaining a deduction for manufactured interest. It was common ground that the deduction was available. HMRC then tried unsuccessfully to argue that the deduction was matched by a charge under the accrued income scheme. Henderson J concluded by reflecting that in a tax system as complex as the UK's, there would inevitably be some gaps of which taxpayers would be able to take advantage[8].

The courts' usual approach to schemes can be contrasted with the case of *Jones v. Garnett* (aka '*Arctic Systems*'). This – as is well known - concerned a scheme to save tax and NICs, whereby a husband and wife established a company and owned the shares equally. The company provided the services of the husband as IT consultant to agencies. The wife undertook administrative tasks for 4 to 5 hours per week. The husband was paid only a nominal salary, and the remainder of the profits were distributed equally. HMRC contended that the settlements legislation, contained (at the material times) in Chapter 1A Part X ICTA 1988,

applied, so that income gifted to the wife was treated as that of the husband for tax purposes. The House of Lords agreed with HMRC that the arrangement did involve an "element of bounty", so that the settlements legislation was in point; however, the arrangement constituted an "outright gift" between spouses, so that the exception in s.660A(6) applied. My own view is that *Jones* was wrongly decided, at least as a matter of technical law. Mr. Jones did not make an "outright gift" of his income to his wife: rather he made a continuing gift by failing to demand a market salary for the work which he did. On a normal reading of the statute, HMRC should clearly have won. However, the House of Lords was alive to the perceived merits of the case and took account of the fact that HMRC had used wide-ranging anti-avoidance powers aimed at trusts to challenge a long-established and apparently accepted kind of planning, the ultimate result of which was to share the benefit of lower tax rates between spouses. Their Lordships were therefore happy to take a rather strained view of both the law and the facts to achieve what they considered to be the just result. It is suggested that *Jones v Garnett* is an example of a very rare species of tax case indeed: cases where the courts feel that a scheme has sufficient (non-technical) merit that potentially applicable anti-avoidance legislation is found not to apply.

Challenges to Aggressive Self-Assessments

The second major species of case is what might neutrally be termed as challenges to "aggressive self-assessments". It is thought that, as HMRC has become

better organised and more business-oriented, the attacks which it makes are becoming more concentrated against individual business sectors, and particular transactions which recur frequently. These kinds of challenges are likely to continue to be made and some of them are discussed below. Although the issues at stake differ, cases where HMRC challenges what it perceives as an unjustified self-assessment often tend to follow a similar kind of pattern. The essential question is whether the judge decides to agree with HMRC that the particular self-assessment is a step too far and therefore abusive, or whether the taxpayer has self-assessed legitimately. This kind of case is inherently more winnable than one which involves defending a scheme, but it is still difficult. Taxpayers should also bear in mind that HMRC is likely to put forward weak (for the taxpayer) test cases on any given issue. The way the facts are presented and how the Commissioners react to them are therefore of key importance. HMRC is likely, if at all possible, to paint a picture of abuse, and in response the taxpayer must show the inherent commerciality of what has been done in order to capture the merits of the case. It will help the taxpayer to show the sensible commerciality behind what he has done, just as being shown to have undertaken a scheme will damage him.

Residence Challenges

Challenges to the residence of both companies and individuals remain popular with HMRC. The most important recent case as regards individuals is *Gaines-Cooper v. HMRC*[9]. The taxpayer was born (in 1937) and

educated in England. From 1958 he ran various UK businesses. In the mid 1970s he developed business interests abroad, bought a house abroad and spent large amounts of time overseas and declared himself non-resident. At all times he retained a house in the UK which was available for his and his family's use during the years of assessment in question (1992 to 2004) although it had been let for earlier years. The taxpayer worked in the UK during some of the disputed years under a UK contract of employment. The issue was whether the taxpayer was resident and ordinarily resident in the UK and domiciled in England during the relevant tax years. The Special Commissioners decided that he was, and an appeal on domicile was recently dismissed by the High Court.

The result of *Gaines-Cooper* is well-known, but it is perhaps worth considering some aspects of the reasoning. The Commissioners' decision begins with a 22-page account of the taxpayer's adult life. This is clearly designed to read in a (rather odd) neutral way and to negate the way in which the taxpayer and his advocates had sought to present the facts. Considerable emphasis is put on small details. For example, it clearly did not help the taxpayer that he had made planning applications describing his UK home as being "used wholly ... as his private UK residence." Unsurprisingly, the taxpayer relied on IR20 and ignored the dates of arrival and departure and unusual events. The Commissioners, equally unsurprisingly, declared they "must apply the law rather than the provisions of IR20". However, HMRC, contrary to IR20, argued that to

ignore both dates of arrival and departure and single days (where arrival was on one day and departure the next) was distortive. HMRC argued that a visit where the taxpayer arrived on one day and left on the next should count as one day: one should look at the nights spent in the UK, an approach which the Commissioners accepted. On the issue of residence, the taxpayer lost because of the time spent in the UK, because he had a permanent residence in Henley, and because his family lived here and he had business here. The day-count figures are not dealt with until para.92 of the decision. Section 336 ICTA did not provide an escape, because his residence was not “temporary” in purpose - in the sense of a transient purpose, as distinguished from pursuance of the regular habits of his life[10]. To acquire a domicile of choice, the taxpayer had to demonstrate both residence and an intention of permanent residence. If a person is resident in two countries then the country of domicile must be his main residence. Evidence as to intentions is weighed up in the light of all the facts. Ultimately the taxpayer lost because of the continued strength of his connections with the UK and his failure to establish his family permanently in the Seychelles[11].

Challenges to the Tax Treatment of Termination Payments

This is another popular challenge for HMRC, which may become more topical given the state of the economy. The issue is whether termination payments are taxable as earnings or only under s.401 ITEPA (formerly s.148 ICTA) - so that the first £30,000 is exempt. HMRC

tends to leave redundancy payments alone, even if these are increased above the statutory entitlement, provided that they are referable to the statutory formula and can genuinely be shown to have been paid to ease hardship. The usual battleground concerns payments which the taxpayer claims are damages, especially when the employer has a right to make a payment in lieu of notice or "PILON". The key distinction as regards PILONs is between payments made under the contract itself, which are taxable, and payments made as damages for breach of the employment contract, which are not taxable as earnings but are compensation for a breach of contract, as in *Cerebus Software v. Rowley*[12]. Where the contract is ended by mutual consent, and a payment is made by the employer, who has a right to make a PILON, the amount will be taxed as earnings - following *Richardson v Delaney*[13], because it is paid under the contract rather than as damages for breach. To avoid the termination payment being taxable as earnings, where there is a provision for an employer to make a discretionary PILON payment, the solution is to terminate the employment in breach of contract and without agreeing to pay anything before settling the damages.

Termination payments have been the subject of two recent cases. In *SCA Packaging Ltd v. HMCE*[14], employees who had the benefit of notice periods in their contracts of employment, were made redundant. A memorandum agreed by the employees' trade union, which was supplemental to their employment contracts, gave the employees the right to be paid in lieu of notice in the event that their employments were terminated. The

relevant employees agreed to PILONS being made when they were made redundant. HMRC argued that the PILON payments were chargeable as employment income in the normal way as emoluments. The taxpayers contended that the payments were only taxable under what was then s.148 ICTA 1988. Lightman J agreed with HMRC. The key point was that the employees were entitled to the payments under their contracts upon termination of their employments: "[t]he payments were made under and pursuant to the provisions in their contracts of employment ..." Lightman J's decision is clearly correct. The source of the payments was the employment contract itself rather than a secondary right to damages which only arose upon breach of the employment contract.

In *McGrotty v. HMRC*[15] the taxpayers were directors of a company whose employment contracts contained a discretionary PILON clause. The taxpayers' employment contracts were terminated by mutual consent. The taxpayers were paid sums described as 'pension contributions' and compensation for "loss of share option rights". It was accepted that there was no contractual entitlement to these sums. However, HMRC argued that they were taxable under s.148 ICTA 1988 (subject to the £30,000 exemption) as received in connection with the termination of a person's employment and not otherwise chargeable to tax. Unsurprisingly, the payments were found to be chargeable under s.148 ICTA, as they formed part of the consideration in exchange for which the employment was terminated by mutual agreement.

IR 35 Avoidance Arrangements and Contractors Operating Through Companies

The first step in any tax dispute is to establish the facts. Sometimes a proper review of the facts will quickly establish the correct tax position. For example, as stated above, where the tax treatment of termination payments is at issue - most frequently when a payment is made by an employer who has the benefit of a discretionary PILON clause, the issue is simply whether that payment was made following a termination of employment in breach of contract, so that it is damages. Where tax planning has not been properly implemented, which seems to be a frequent problem with "IR 35" planning involving so-called composite companies, then the taxpayer may be struggling to make a case. If these kinds of issue are properly identified prior to a hearing, the case is unlikely to proceed to trial. If the hearing starts by unravelling the facts and this produces a clear answer then the case can easily be disposed of.

The first issue in an IR 35 case is whether the structure has been set up properly. If the implementation is defective, HMRC will typically claim the PAYE tax from the agency responsible for creating the structure. If the structure has been implemented correctly, then, prior to the new legislation on managed service companies, HMRC's attack was under IR 35, contending that the hypothetical relationship between contractor and end client amounted to employment. In *Island Consultants Ltd v. HMRC*[16] the Appellant ("IC") contracted with an IT agency to provide the services of Mr. H, its

shareholder and director, ultimately to Severn Trent Water. HMRC concluded that the arrangement was caught by the IR 35 legislation. The taxpayer's appeal was dismissed. The relevant hypothetical contract was between IC and the ultimate client. The Special Commissioner considered the 'badges of employment' in the context of the hypothetical contract. The factors predominantly pointed towards employment.

Despite succeeding in a number of IR 35 cases, HMRC has brought in the new rules on Managed Service Companies. The new rules illustrate the problems with IR 35, which were the need to make individual challenges, the inability to recover tax which was found to be due and the lack of deterrent effect. A serious cause for concern for HMRC and taxpayers alike is whether the new rules are being properly adhered to.

Salaried Persons Postal Loans and The Question of What is a business?

Where there is real doubt as to how the law applies to the particular facts, then there is scope for open litigation. It will help the taxpayer to demonstrate that it is carrying on its normal business and that HMRC is making an unreasonable challenge. Some cases will involve arguing an open point of law on agreed facts. An example of this is *Salaried Persons Postal Loans Ltd v. HMRC*[17], where **a** company which had ceased to trade let out its former trading premises, which it had vacated in 1966. There had been a single tenant since 1966. HMRC concluded that the company carried on a 'business', so that it was an associated company for the purposes of

computing the level of small companies' relief under s.13 ICTA 1988. The taxpayer appealed and denied that the company carried on any business. The Special Commissioner (Dr John Avery-Jones) found in favour of the taxpayer, and Lawrence Collins J upheld the decision on appeal. HMRC unsuccessfully relied on the judgment of Lord Diplock in *American Leaf Blending v. Director General of Inland Revenue*[18], where he said that "[w]here the gainful use to which a company's property is put is letting it out for rent their Lordships do not find it easy to envisage circumstances that are likely to arise in practice which would displace the prima facie inference that in doing so it was carrying on business." Nevertheless, the Special Commissioner found that on the particular facts the lack of activity relating to the investment meant that there was no business. The High Court declined to overturn the decision as there was no error of law.

The decision clearly has relevance beyond the associated companies rules. For example, if investment properties are transferred to a company then there is an issue as to whether they qualify as a business for the purposes of relief under s.162 TCGA 1992. HMRC's Manuals state that the mere passive holding of property is unlikely to qualify for s.162 relief, and it is understood that it may be taking this point more aggressively. Nevertheless, my view is that *Salaried Persons* is an exceptional case. The property simply sat where it was for over 30 years with the same tenant. The general lack of activity means that there is no business. This follows *Jowett v. O'Neill*[19] where cash sitting on deposit did not

amount to a business. Generally, *Salaried Persons* will not prevent taxpayers from concluding that there is a business when property is let[20].

How to Successfully Avoid and Defeat HMRC Challenges?

The best scenario of course is to avoid disputes with HMRC entirely. The way to try and achieve this is to ensure that the taxpayer's self-assessment position is as strong as possible. If deliberate planning is undertaken, or the taxpayer takes an aggressive filing position, there is inevitably going to be some risk of challenge (unless HMRC has expressly indicated that it approves of the planning). Recent cases reiterate that if there is more than a hint of tax planning involved and HMRC shows the taxpayer's position to be aggressive, he is in trouble even if he has not done a scheme: see, for example *Gaines-Cooper* and Island Consultants, discussed above.

There will always be disputes because it is not the job of taxpayers to resolve points of doubt in favour of HMRC. Risk of challenge can be minimised by taking proper advice at the outset and not doing anything which is too provocative. It is may well be better to play a little safer rather than to push the boundaries: the *Gaines-Cooper* appeal is a perfect illustration of this. Failure to take proper advice and to implement a tax saving idea in the correct manner can be very costly in the event of a challenge. On the other hand, steps taken to guard against a *Ramsay* attack can be exposed as nothing more than that: see eg *Astall*. If a challenge does arise then the

stronger the taxpayer's position, the greater the chance he has of succeeding. It is in the taxpayer's interest to adopt an appropriate litigation strategy at the outset. If he has a strong case, it may be suitable to try and present it comprehensively to HMRC at an early stage, rather than respond piecemeal to correspondence and hope the challenge goes away. Taxpayers with strong cases are often well-advised not to be bullied by HMRC or to allow them to enter into protracted correspondence, but rather to invite them to issue assessments so that an early appeal can be brought.

If the case reaches the Commissioners, it is crucial that the taxpayer gives himself the best chance of winning. The High Court is notoriously reluctant to interfere with the Commissioners' decisions, unless there is a clear error of law. So, when a case turns on the facts – which one way or another it inevitably does - it is important that the taxpayer does everything he can to win before the Commissioners, because there are no second chances. The key is to try and demonstrate the merits in the taxpayer's case, and this must be done by proving the relevant facts. There is no substitute for proper preparation. The points of law where evidence is required must be identified and the relevant evidence obtained. Every opportunity should be taken to prove the taxpayer's case, so witness statements must be drafted. Thought must be given to what witnesses are needed and whether expert evidence is required. It can be very dangerous to assume that the Commissioners will infer what the taxpayer considers is obvious. Taxpayers should beware of the Commissioners appearing less

rigorous and more easily satisfied that the burden has been shifted than they actually are. I would also recommend against simply agreeing a statement of facts drafted by HMRC as they will naturally have been written in a manner favourable to HMRC.

To prepare a case properly due consideration must be given to the weaknesses in the taxpayer's case and how HMRC is likely to try and exploit them. What to do will depend on the facts of the particular case. As a general rule, it is likely to be better to try and deal with potentially unfavourable facts in the taxpayer's witness statement and during examination in chief, rather than let HMRC have a field-day during cross-examination. In this regard, it is important that the advocate tests the witness's evidence beforehand: there is nothing worse than having some detrimental fact unexpectedly appear during cross-examination. Witness familiarisation courses are increasing in popularity, but the best (and only) advice to witnesses is simply to answer all the questions as truthfully as they can. It is a dangerous tactic for a witness to try and anticipate a line of cross-examination or to play games with the advocate. At risk of stating the obvious, witnesses must never be told what answers to give and coaching is contrary to the Bar's Code of Conduct. Taxpayers and their witnesses can expect to be robustly challenged during cross-examination from HMRC. Some of the sting may be taken out of this by having the witness deal with likely cross-examination questions in advance. The taxpayer's advocate may also object to any questions by HMRC which are too vague or irrelevant. Aggressive cross-

examination can also be counter-productive, especially if it fails to achieve its ends. The taxpayer's advocate should keep this in mind when cross-examining HMRC's witnesses. At all times the taxpayer's advocate should try to marshal the evidence so that it supports his theory of the case and underlines the taxpayer's merits. Where the taxpayer's case lacks merit - generally because he has done an aggressive scheme, it will help if the facts are kept to a minimum, so that the argument can focus on the technical merits, but HMRC is unlikely to allow this!

The Future of Tax Litigation?

Looking to the future, there is likely to be more direct tax litigation than in previous years. Some of this will be challenges to schemes, where HMRC will usually start as favourites. Other litigation will determine the boundaries of the legislation, sometimes on fundamental issues but also on more obscure points. Given the volume of the modern tax code there is no shortage of points to litigate! However, my suggestion is that HMRC is likely to pick on points which will recur time and again, such as company residence. In some cases, once the facts are cleared up there is a clear answer or at least a point of law. A case on a novel point of legal principle, where there is no scheme involved, is quite different from one which turns on the facts. Where there is no legal bright line rule, then how the Commissioners react to the facts is crucial, and so presenting them properly is the challenge for the taxpayer's advocate. As ever, the best way is to avoid litigation altogether, and the chances

of this are maximised by the taxpayer obtaining detailed advice at the outset so that it is harder for HMRC to challenge the self-assessment position.

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[1] Which is based on a talk I gave for Longmark Conferences on 18 November 2007. The conference was aimed at SMEs and the cases discussed reflect that bias.
[2] [2006] STC 1908.
[3] In *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 approved by the House of Lords in *Barclays Mercantile v Mawson* [2005] STC 1
[4] [2007] SpC 617
[5] [2007] SpC 628
[6] See eg *Herman v HMRC [2007] Spc 609*, where the "Mark 2 Flip Flop Scheme" was accepted as achieving its aim preventing stockpiled gains in one trust being carried into another but was defeated on the basis that the gains from the first trust could be attributed to the beneficiaries under s.87(4) TCGA 1992.
[7] [2007] EWHC 163.
[8] See at para.47 of his judgment.
[9] [2006] SPC 00568.
[10] In the PBR HMRC states that legislation will be introduced in the 2008 Finance Bill to ensure that when determining if an individual is resident in the UK in any year, days of arrival and departure are covered. This is subject to a consultation and will apply after 6 April 2008.
[11] A number of taxpayers are seeking judicial review of HMRC's refusal to apply IR20: none is yet understood to have obtained leave.
[12] [2001] IRLR 66
[13] [2001] STC 1328
[14] [2007] EWHC 27 (Ch)
[15] [2007] STC (SCD) 582
[16] [2007] SpC 618
[17] [2006] SR 1315

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[18] [1978] STC 511

[19] [1998] STC 482 per Park J

[20] See also *Rashid v. Garcia (Status Inspector)* [2003] SCD 36 where it was held, again by Dr. John Avery-Jones, that receipt of rents did not make the taxpayer self-employed for NICs purposes as he did not carry on any "business". This decision is more open to attack. It perhaps demonstrates that, despite what the courts might say, the test applied varies depending on the context. In *Rashid* the taxpayer, who had spent time in prison, was trying to claim benefits. The result may have been different had he been claiming s.162 relief?