WHY THE FIRST-TIER TAX TRIBUNAL DEFINITELY HAS JUDICIAL REVIEW JURISDICTION

by Michael Firth

Introduction

The Tax Tribunals have made a fundamental error of law with far-reaching consequences and to the significant disadvantage of taxpayers, particularly those with modest means. The error took hold in two Upper Tribunal decisions *(HMRC v. Noor* [2013] STC 998 and *HMRC v. Hok Ltd* [2013] STC 225), heard by the same Judges and in neither of which (astonishingly) was the taxpayer represented. Since then, the error has been repeated numerous times and, unlike the physical realm, the legal realm is one where it is indeed possible for something to become true simply because it has been said enough times. The purpose of this article is to fully explain the error in the hope that it is corrected before it ceases to be an error.

It will not have escaped the attentive reader's attention that a clue as to what error is referred to was hidden in the title of the Article: it is, indeed, the error of holding that the First-tier Tax Tribunal does not have judicial review jurisdiction. The, now classic, exposition of this (with respect) error is *HMRC v. Hok Ltd* [2013] STC 225, where Warren J and Judge Bishopp entertained absolute certainty as to the correct conclusion:

> "There is in our judgment no room for doubt that the First-tier Tribunal does not have any judicial review jurisdiction." (§41).

In support, five reasons were given:

(1) The Tribunal is a statutory body, and neither the statute

creating it, nor the statutes it is required to apply, give it jurisdiction to apply public law principles (§36) or to apply "common law principles" (§56).

(2) The structure of the legislation, in conferring a judicial review function on the Upper Tribunal but not the First-tier Tribunal makes it "perfectly plain" that Parliament did not intend to confer judicial review jurisdiction on the First-tier Tax Tribunal (§43). Parliament must be taken to have understood the difference between statutory, common law and judicial review jurisdictions. (§57).

(3) A taxpayer who relies on a public law principle is not saying that the facts necessary to give rise to a tax liability do not exist but that, because of some further facts, it would be oppressive to enforce that liability (§§39 – 40, relying on *Aspin v. Estill (Inspector of Taxes)* [1987] STC 723).

(4) The decision of the House of Lords in *CEC v. JH Corbitt (Numismatists) Ltd* [1980] STC 231 ("*Corbitt*") binds the Tribunals to conclude that they may not apply public law principles. (§41).

(5) Cases such as *Wandsworth London BC v. Winder* [1984] 3 All ER 976 concerned the validity of the act of a public authority and thus raised different questions to those in issue in *Hok* (§52).

Each of these reasons, however, discloses a single, fundamental misunderstanding as to the constitutional basis for judicial review. Once that misunderstanding is corrected, it becomes clear that the FTT definitely has judicial review jurisdiction. Indeed, it would require very clear statutory words to stop the FTT having such jurisdiction.

One clarification that should be made at the outset is the meaning of "jurisdiction", which is a word of "some ambiguity":

> "Both the deputy judge and the Vice-Chancellor referred to the issue as one of "jurisdiction". But jurisdiction is a word of some ambiguity. The ambiguity was referred to

by Pickford LJ in *Guaranty Trust Co of New York v Hannay & Co* [1915] 2 KB 536 at 563. He said:

> "The first and, in my opinion, the only really correct sense of the expression that the Court has no jurisdiction is that it has no power to deal with and decide the dispute as to the subject matter before it, no matter in what form or by whom it is raised. But there is another sense in which it is often used, i.e., that, although the Court has power to decide the question it will not according to its settled practice do so except in a certain way and under certain circumstances." (Fourie v. Le Roux [2007] UKHL 1, §25)

The argument in the main part of this article is that the FTT has jurisdiction in the "only really correct sense". In the conclusion it is briefly considered whether the FTT ought not to use the jurisdiction that it has (jurisdiction in the broader sense).

The constitutional basis of judicial review

As all students of constitutional law are taught, Parliament is sovereign. In practical terms, that means that Parliament can make any law it likes, and the Courts must give effect to the laws properly passed by Parliament. Statutory interpretation is part of this process as it is aimed at discerning Parliament's intention. In exercise of this sovereignty, Parliament often gives powers to public authorities, including HMRC. When a power is so given, it logically follows that there will be acts that are within the scope of the power, properly interpreted, (*intra vires*) and acts that are outside the scope of the power, properly interpreted, (*ultra vires*). If an act is outside of the scope of the power, then – quite obviously – it is unlawful, and the Courts can and should intervene. On the other hand, if a particular act is within the scope of the power, it would be a subversion of the principle of Parliamentary sovereignty for

Parliamentary sovereignty, they are required by it (because they give effect to the presumed intention of Parliament).

At this point, the reader may be sceptical as to how realistic it is to be able to find an intention on the part of Parliament that each power it confers on a public authority should be exercised in accordance with the varied and nuanced principles of public law. Those principles themselves, it may be noted, do not stand still, yet Parliament does not appear to prompt such changes. Such sceptical readers are, in fact, in good company. There are those out there who argue that the foundations of judicial review are in the common law, as developed by the judges, rather than the doctrine of *ultra vires* based on presumed Parliamentary intention.

Two points needs to be made in response. First, despite the fact that you will not find any consideration of these issues in the cases on the jurisdiction of the Special Commissioners or the FTT, it is not a new debate. It has been a live topic in academic circles for decades (at least), there are entire books devoted to the topic (for example, Judicial Review and the Constitution (2000), Forsyth ed.) and all the major textbooks on administrative law address the issues (for example, Wade and Forsyth, 11th edition, at pp.27 – 31). Second, whilst there is an academic debate on the proper constitutional justification for judicial review, the authorities are clear that the answer is the doctrine of *ultra vires*:

> "But in 1969, the decision of your Lordships' House in *Anisminic Ltd v. Foreign Compensation Commission* made obsolete the historic distinction between errors of law on the fact of the record and other errors of law. It did so by extending the doctrine of *ultra vires*, so that any misdirection in law would render the relevant decision *ultra vires* and a nullity…" (*Boddington v. British Transport Police* [1999] 2 AC 143 at 154, Lord Irvine with whom Lord Hoffmann agreed).

the Courts to strike down or otherwise interfere with that act - by definition it is an act that Parliament has authorised the public authority to perform and thus lawful.

How, then, does one fit the principles of judicial review within this constitutional framework? The answer, supported by high authority, is the doctrine of "*ultra vires*". According to this doctrine, when Parliament enacts a statute giving a public authority a power, there will be some limits on that power that are expressly set out in the statute, but there are others that are implied in to the statute on the basis that Parliament is presumed to have intended such limits. For example, when Parliament gives a public authority the power to make a decision, it is presumed that Parliament did not intend to authorise that public authority to make a decision that was wholly unreasonable in the sense that no reasonable public authority could have taken such a decision. Similarly, Parliament is presumed to have intended that decisions by public authorities must be reached by a procedure that respects the principles of natural justice.

What this means, in constitutional terms, is that the limits imposed on public authorities by the principles of public law/ judicial review come from <u>within the statute</u> conferring the power itself. They arise through the process of statutory interpretation and as a result of the exercise of Parliament's intention. It is as if in the specific legislation conferring the power Parliament included an additional section or subsection specifying further conditions to the effect that the public authority may only make a decision that is reasonable and complies with the principles of natural justice. What it means in practical terms is that any purported exercise of the power that fails to comply with public law principles is outside the scope of the power granted by parliament (i.e. ultra vires) and thus void. Following this point through to its logical conclusion, the principles of judicial review are not only consistent with

> "I adhere to my view that the juristic basis of judicial review is the doctrine of *ultra vires*." (*Boddington* at 164, Lord Browne-Wilkinson)
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> "I see no reason to depart from the orthodox view that ultra vires is 'the central principle of administrative law' as Wade and Forsyth, Administrative Law, 7th ed, p.41 described it." (*Boddington* at 171, Lord Steyn with whom Lord Hoffmann also agreed)

Other cases are equally clear that the foundation of public law principles is Parliament's presumed intention:

> "Where wide powers of decision-making are conferred by statute, it is presumed that Parliament implicitly requires the decision to be made in accordance with the rules of natural justice: Bennion on Statutory Interpretation, p.737." (*R v. Home Secretary ex p. Pierson* [1998] AC 539 at 550)
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> "In all cases…this intervention by way of prohibition or *certiorari* is based on the proposition that such powers have been conferred on the decision maker on the underlying assumption that the powers are to be exercised only within the jurisdiction conferred, in accordance with fair procedures and, in a Wednesbury sense… reasonably. If the decision maker exercises his powers outside the jurisdiction conferred, in a manner which is procedurally irregular or is Wednesbury unreasonable, he is acting *ultra vires* his powers and therefore unlawfully: see Wade, Administrative Law, 6th ed (1988) pp.39 et seq." (*R v. Lord President of the Privy Council, ex parte Page* [1993] AC 682 at 701, Lord Browne-Wilkinson).
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> "…it is to be implied, unless the contrary appears, that Parliament does not authorise by the Act the exercise of powers in breach of the principles of natural justice, and that Parliament does by the Act require, in the particular procedures, compliance with those principles." (*Fairmount*

> *Investments Ltd v. Secretary of State for the Environment* [1976] 1 WLR 1255 at 1263, Lord Russell).

The purpose of setting out so many authorities is to show that the point is beyond doubt, as a matter of law: public law principles limit public authorities, because they are implied into the power-conferring statute as a matter of statutory interpretation in order to give effect to the presumed intention of Parliament. Furthermore, a purported exercise of a power that is contrary to public principles is not a valid exercise of the power at all – it is a nullity:

> "The break-through that the *Anisminic* case made was the recognition by the majority of this House that if a tribunal whose jurisdiction was limited by statute or subordinate legislation mistook the law applicable to the facts as it had found them, it must have asked itself the wrong question, i.e. one into which it was not empowered to inquire and so had no jurisdiction to determine. Its purported 'determination', not being 'a determination' within the meaning of the empowering legislation, was accordingly a nullity." (*O'Reilly v. Mackman* [1983] 2 AC 237 at 278).

> "It has long been settled law that a decision affecting the legal rights of an individual which is arrived at by a procedure which offends against the principles of natural justice is outside the jurisdiction of the decision-making authority. As Lord Selborne said as long ago as 1885 in *Spackman v. Plumstead District Board of Works* (1885) 10 App.Cas. 229, 240: "There would be no decision within the meaning of the statute if there were anything…done contrary to the essence of justice." See also *Ridge v. Baldwin* [1964] AC 40." (*AG v. Ryan* [1980] AC 718 at 730, Privy Council).

With the proper constitutional basis of judicial review in mind, it is now possible to understand, first, why the FTT definitely has judicial review jurisdiction (in the sense of the ability to adjudicate on the application of public law principles to the facts before it); and, second, why the decisions holding that the FTT has no judicial review jurisdiction are wrong.

The FTT's judicial review jurisdiction

What is true of the constitutional basis for judicial review of public authorities decisions generally must also be true of judicial review of HMRC decisions. It follows that when, for example, HMRC purport to exercise their power in TMA 1970 s.29 to raise a discovery assessment, they do so against a background of public law requirements implied into s.29. Further, the effect of a breach of one of those public law requirements is that the purported assessment is a nullity – there is no assessment within the meaning of s.29. In light of the above, if it is accepted that the FTT has power to determine whether a purported assessment is a valid assessment based on the explicit requirements of TMA s.29 (whether it is in time, whether there was a discovery etc.) then it must be accepted that the FTT also has power to determine whether a purported assessment is a valid assessment based on the implicit requirements. Once implied into the statute, the public law requirements are just as much requirements of the statute as the explicit requirements.

In practice, it is clear that the FTT does have power to consider whether the purported assessment is a valid assessment. That it has such power is so obvious that in most cases it does not need to be considered. In statutory terms such appeals proceed on the basis of (usually) TMA s.49G:

> "(2) The appellant may notify the appeal to the tribunal within the post-review period.
> (3)…
> (4) If the appellant notifies the appeal to the tribunal, the tribunal is to determine the matter in question [i.e. the matter to which the appeal relates – s.49I]."

If the Tribunal decides on such an appeal that there is no valid assessment, for instance, because it is out of time, that is a binding decision on the parties, with the effect that HMRC have nothing to enforce through collection proceedings.

Note, in this respect, that TMA s.50(6) (which gives a power to reduce assessments where the taxpayer is overcharged) does not restrict the FTT's jurisdiction – that subsection applies where there is a valid assessment but the amount is too high. A declaration to that effect would not, in many cases, have the desired legal effect, because, ex hypothesi, there is a valid assessment. Section 50(6) is a necessary additional power, as it allows effect to be given to the Tribunal's decision and, in fact, it appears that it is HMRC rather than the FTT that exercises the power under s.50(6):

> "The draftsman must in my judgment have considered that any alteration of the assessment consequent on an appeal fell to be made by the assessing body and not by the appellate body. The fact that Parliament has taken the trouble to alter [TMA s.50(6)] so as to delete the express requirement that the commissioners are to alter the assessment is a clear indication that they are not the body which henceforward would be responsible for making the necessary alterations. This statutory history is wholly consistent with the conclusion that following an appeal, the necessary amendments fall to be made by the inspector or the Board as the assessing body." (*Hallamshire Industrial Finance Trust Ltd v. IRC* [1979] STC 237 at 243)

Returning to the question of whether the FTT has power to determine the validity of an assessment, not only is this borne out by the legislation, it is confirmed by the authorities:

> "The jurisdiction of the Special Commissioners is not limited to situations where the taxpayer claims to have been overcharged by a valid assessment. The jurisdiction

covers situations where the taxpayer contends that there is no charge on grounds that the document purporting to be the assessment is invalid or ineffective. The most usual case is where the assessment is challenged as being out of time. Another example is where the taxpayer contends that the assessment is on the wrong person (eg where the assessment is on him as an individual whereas he claims he should have been assessed as a trustee). A further example of a challenge to the validity of the assessment that falls within the Special Commissioners' jurisdiction is where the taxpayer contends that the assessment officer did not have had the Board's authority to make the assessment. The words of s 50(6) do not, expressly or by necessary implication, restrict the scope of the appeal commissioners and prevent them from examining the validity of the assessment on those grounds. Indeed, s 29(8) expressly provides for an appeal on the grounds that neither of the conditions in subsections (4) and (5) are fulfilled." (*Khan v. Director of the Assets Recovery Agency* [2006] STC (SCD) 154 at §15).

"However, it is said that the inspector was not entitled to make assessments at all because the profits of prostitution are not assessable to tax, and that accordingly such assessments were ultra vires and of no effect. In my opinion there are two objections to that submissions. The first is that it is not open to the taxpayer, in collection proceedings, to raise such a contention. If it is to be raised, it must be raised on the appeal and argued therein." (*IRC v. Aken* [1990] STC 497).

In conclusion of this section, it has been established that:

(a) A purported assessment that is contrary to public law principle is not, as a matter of statutory interpretation, an assessment within the meaning of the relevant provision of TMA 1970; and

(b) Tax Tribunals have jurisdiction (indeed an obligation) to determine whether there is a valid assessment.

Combining these conclusions leads to the further conclusion that Tax Tribunals do have jurisdiction to determine whether an assessment is invalid due to it being contrary to public law principles. The following sections explain why none of the reasons relied upon by the Upper Tribunal in *Hok* affect this conclusion.

Reason 1: the FTT is a statutory body with no judicial review jurisdiction/jurisdiction to apply common law principles

An important part of the reasoning in cases such as *Hok Ltd* is that the FTT is a statutory body which only has the jurisdiction conferred upon it by statute:

> "Once it is accepted, as for the reasons we have given it must be, that the First-tier Tribunal has only that jurisdiction which has been conferred on it by statute, and can go no further, it does not matter whether the Tribunal purports to exercise a judicial review function or instead claims to be applying common law principles; neither course is within its jurisdiction. As we explain at paras 36 and 43 above, the Act gave a restricted judicial review function to the Upper Tribunal, but limited the First-tier Tribunal's jurisdiction to those functions conferred on it by statute. It is impossible to read the legislation in a way which extends its jurisdiction to include – whatever one chooses to call it – a power to override a statute or supervise HMRC's conduct." (§56).

The flaw in this reasoning should now be readily apparent – public law principles absolutely do not entail a Court or Tribunal "overriding a statute" because Courts have no more authority to override statutes than Tribunals do. This is the very essence of the *ultra vires* principle: Parliamentary sovereignty is only respected if the limits on the power are found, expressly or implicitly, in the provision conferring the power. The FTT undoubtedly has the power to apply the provisions of TMA 1970 and thus undoubtedly has power to apply the public law limits implied into that statute.

For the same reason, references to the common law are misconceived (paragraphs 12, 26, 38, 44, 50 and 52 of *Hok*).

Confirmation that the fact that the FTT was created by statute does not prevent it applying public law principles can be found by looking at other statutory bodies so created (and thus lacking the "inherent" jurisdiction of the High Court). *Wandsworth London BC v. Winder* [1985] AC 461 was a case in which it was held that a county court was entitled to dismiss a claim for possession due to arrears of rent on the basis that the local authority's purported exercise of its power to increase rent (under the Housing Act 1957) was contrary to public law principles. County courts were established by statute and thus were statutory bodies (at the time County Courts Act 1959, s.1, now repealed). Jurisdiction was granted in respect of:

- Contract and tort claims for less than £400 (s.39).
- Actions for the recovery of land (s.48).
- Specified proceedings relating to equity (s.52).
- Probate (s.62).

There was no "jurisdiction" in respect of judicial review and no power to grant any judicial review remedy. This is now further emphasised by County Courts Act 1984 s.38(3), which states that a county court shall not have power to order *mandamus*, *certiorari* or prohibition, whereas s.29 of the Supreme Courts Act 1981 expressly grants such remedies to the High Court, and s.31 provides that applications for such remedies "shall be made in accordance with rules of court by a procedure to be known as an application for judicial review". Also similar to the FTT is the fact that the county court, as a creature of statute, has no inherent jurisdiction (see, for example, *Re B* [1996] 1 WLR 716).

Despite this, the House of Lords held in *Winder* that the county court was entitled to hear and decide the question of whether the decision to increase rent was invalid on public law grounds. The questions of whether the county court had "a general supervisory jurisdiction" or a "judicial review jurisdiction" were irrelevant because the defendant was not asking for a judicial review remedy, simply that it be recognised that the purported increase in rent was invalid on public law grounds and thus the claim dismissed:

> "Apart from the provisions of Order 53 and section 31 of the Supreme Court Act 1981, he would certainly be entitled to defend the action on the ground that the plaintiff's claim arises from a resolution which (on his view) is invalid." (Lord Fraser at 509).

Instead, the question was whether it was an abuse of the process of the court for the tenant to take the invalidity point in the county court by way of defence rather than commence judicial review proceedings. The House of Lords held that there was no abuse of process.

Precisely the same result was reached in respect of a claim to collect tax in *Pawlowski v. Dunnington* [1999] STC 550 where it was accepted that the question of whether a determination under PAYE regulations was invalid on public law grounds could be raised in the county court. Oddly, the Upper Tribunal seemed to understand *Winder* in *Hok* (§52) but did not go on to apply the same logic to the result of finding that a penalty determination in the context of taxation violated public law principles. Technically the upper Tribunal was right that there was no power to "discharge" a penalty determination (§58), but there was power to decide whether there was a valid penalty determination in the first place.

Reason 2: the structure of the legislation makes it plain that the FTT was not intended to have judicial review jurisdiction

The Upper Tribunal explained as follows in *Hok*:

> "That the First-tier Tribunal has no judicial review

> function is, in addition, the only conclusion which can be drawn from the structure of the legislation which brought both that Tribunal and this into being. The 2007 Act conferred a judicial review function on this Tribunal, a function it would not have had (since it, too, is a creature of statute without any inherent jurisdiction) had the Act not done so; and it hedged the jurisdiction it did confer with some restrictions. It is perfectly plain, from perusal of the Act itself, that Parliament did not intend to, and did not, confer a judicial review jurisdiction on the First-tier Tribunal, and there is nothing in the more detailed legislation relating to tax appeals, the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009, SI 2009/56, which points to a contrary conclusion."

In fact, what Parliament did in the TCEA 2007 was to grant the Upper Tribunal power to award judicial review remedies:

> "The Upper Tribunal has power, in cases arising under the law of England and Wales or under the law of Northern Ireland, to grant the following kinds of relief—
> (a) a mandatory order;
> (b) a prohibiting order;
> (c) a quashing order;
> (d) a declaration;
> (e) an injunction."

This is no different to Parliament confirming the High Court's power to grant such remedies but explicitly prohibiting the county courts from doing so. As explained above, that in no way affects the county courts' ability to apply the public law principles implied into statutes and recognise that the effect of a breach of such requirements renders the purported exercise of the power a nullity. Similarly, the FTT does not need to able to grant a "quashing order" in order to recognise that a purported assessment is invalid due to public law requirements implied into the TMA 1970. That is not to say that the conferring of a power to grant these remedies on the Upper Tribunal was pointless. On the contrary where, for example, a taxpayer insists that HMRC must take positive action due to public law principles, only a judicial review remedy (a mandatory order) will assist. Put another way, whilst public law principles can render a purported decision a nullity, finding that a decision <u>not</u> to do something is a nullity does not mean that the public authority has done the thing that they were supposed to do.

Reason 3: A taxpayer who relies on public law principles is not alleging that the tax liability has not arisen

The Upper Tribunal sought support for its own view from the Court of Appeal decision in *Aspin v. Estill* [1987] STC 723. Specifically, they cited the following passage:

> "The taxpayer is saying that an assessment ought not to have been made. But in saying that, he is not, under this head of complaint, saying that in this case there do not exist in relation to him all the facts which are prescribed by the legislation as facts which give rise to a liability to tax. What he is saying is that, because of some further facts, it would be oppressive to enforce that liability. In my view that is a matter in respect of which, if the facts are as alleged by the taxpayer, the remedy provided is by way of judicial review." (at 727)

With respect, this passage is wrong, because a taxpayer who relies on public law grounds in relation to an assessment necessarily is (whether he states it expressly, or not) saying that the facts giving rise to a liability to tax do not exist: he is, necessarily, arguing that the assessment is invalid in light of the implied public law conditions. Without a valid assessment, there is nothing to enforce (and thus nothing to ask HMRC not to enforce). In the absence of any consideration of the numerous House of Lords authorities on the constitutional basis and effect of judicial review principles, the decision is *per incuriam*.

The Court of Appeal's reliance on *Preston v. IRC* [1985] AC 835 in support of their conclusion in *Aspin* does not assist, because that was triggered only by the taxpayer's attempt to rely on the case for the opposite conclusion, when in fact the case does not consider the question of the judicial review jurisdiction of the Special Commissioners or FTT at all.

***Reason 4: the decision of the House of Lords in* Corbitt**

Corbitt concerned the application of the VAT margin scheme for works of art, antiques and scientific collections. In order to be entitled to use the margin scheme, a trader had to keep such records and accounts as specified by the Commissioners in a notice. That notice specified the records required to be kept, but reserved a residual discretion to accept other records. The taxpayer wished to take advantage of the margin scheme but had, admittedly, not kept the specified records. The Commissioners refused to exercise their residual discretion in favour of the taxpayer and the House of Lords held, inter alia, that the VAT Tribunal had no jurisdiction to review that decision. The taxpayer in *Corbitt* was in a very different position from that of most taxpayers who seek to rely on public law principles. That taxpayer wanted to take advantage of the margin scheme and, in order to do so, required a <u>positive</u> exercise of the Commissioners' discretion. Until there was such a positive exercise of discretion, the taxpayer could not be said to fulfil the statutory requirements to use the margin scheme. In order to obtain that positive exercise of discretion, it would not be enough to decide that the existing decision on the matter was invalid for public law reasons, because that would simply mean that there was no decision on the question. Only a positive order of *mandamus* could thus achieve what the taxpayer wanted, and it is not suggested here that the FTT has any such power.

On the contrary, what is argued here is that where the taxpayer relies on public law principles solely to show that a purported decision by HMRC is invalid, and does not require anything more, the tax tribunal does have jurisdiction to recognise that invalidity and decide the case before it accordingly. *Corbitt* does not decide otherwise.

Reason 5: Cases such as* Winder *concerned whether a public authority's decision was valid and thus raised a different question

The relevant passage from the Upper Tribunal decision in *Hok* is at paragraph 52:

> "In our judgment neither *Wandsworth v Winder* nor *Rhondda Cynon v Watkins* offers any support to the proposition that the First-tier Tribunal is able to apply (to use the judge's terminology) 'sound principles of the common law' in order to reduce or discharge penalties imposed pursuant to statute. What was in issue in both of those cases was not whether the councils' actions were fair or reasonable, or indeed any general principle of the common law, but whether the actions they had taken had the effect for which they argued—that is, whether the rent had been validly increased, and whether the compulsory purchase order had been vitiated by a subsequent change of mind. Those questions may well have given rise to issues of public law, but they did not give rise to matters for which the only possible remedy is by way of judicial review; and they went, in each case, to the core of the individual's defence of the claims made against him."

This passage, above all others, illustrates why it is so disappointing that the Upper Tribunal took such an important decision in a case where the taxpayer was unrepresented. The Upper Tribunal was absolutely correct when it said that *Winder* concerned the validity of a decision to increase rent, and had it appreciated that that is exactly what the taxpayer was, as a matter of law, saying when it challenged the penalty determination on public law grounds, the course of history might have been different. Instead, the Upper Tribunal understood the taxpayer to be asking it to discharge penalties, validly imposed, on public law grounds. Had the argument been put correctly, based on a proper understanding of public law principles, the taxpayer would have been asking the Upper Tribunal to recognise that there was no valid penalty determination – the same point as in *Winder* and other cases.

Conclusion

For all the reasons set out above, it is beyond doubt that the FTT does have jurisdiction to apply public law principles, as long as the result desired by the taxpayer is that HMRC's decision is a nullity. In the vast majority of cases, that will be exactly what the taxpayer is asking for, whether it be in respect of a purported assessment or a purported amendment to a tax return. Only if the taxpayer wants more than that, for example, a positive order requiring HMRC to take a decision in his or her favour, can it be said that the FTT's jurisdiction is insufficient.

That is not the end of the matter, however. It may come as a surprise to those reading the tax cases on the question of the FTT applying public law principles, but there is a large body of case law, including many cases of high authority, considering precisely the issue of when a litigant may rely on public law principles against a public authority otherwise than in a claim for judicial review (again, all administrative law textbooks deal with the issue at length – see, for example, Wade and Forsyth, 11th Edition, pp.568 – 583). Crucially, however, and by way of confirmation of the points above, these cases consider whether it would be an abuse of process of the court for the public law matter to be raised outside a claim for judicial review. The question of abuse necessarily presupposes that the Court has jurisdiction but may decide not to exercise it, and it is precisely the same question that arises whether the public law issue appears in a tort claim in the High Court or a contractual claim in the County Court.

The starting point, in light of cases such as *O'Reilly v. Mackman* [1983] 2 AC 237, is that it is an abuse of process to raise public law issues outside of a claim for judicial reviews because the protections built into the judicial review procedure are thereby sidestepped (in particular, the three month time limit and the permission stage). There are exceptions, however. In respect of tax appeals in the FTT, two exceptions are relevant:

(1) Public law issues relied upon by way of defence.
(2) Public law issues arising as collateral issues where the person raising them did not select the procedure.

The *Winder* case illustrates these exceptions as it concerned an action for possession by a local council after the tenant refused to pay a rent increase. The tenant's defence was that the decision to raise the rent was void for unreasonableness. In the House of Lords it was held as follows:

> "In any event, the arguments for protecting public authorities against unmeritorious or dilatory challenges to their decisions have to be set against the arguments for preserving the ordinary rights of private citizens to defend themselves against unfounded claims.
>
> It would in my opinion be a very strange use of language to describe the respondent's behaviour in relation to this litigation as an abuse or misuse by him of the process of the court. He did not select the procedure to be adopted. He is merely seeking to defend proceedings brought against him by the appellants. In so doing he is seeking only to exercise the ordinary right of any individual to defend an action against him on the ground that he is not liable for the whole sum claimed by the plaintiff.

> Moreover, he puts forward his defence as a matter of right, whereas in an application for judicial review, success would require an exercise of the court's discretion in his favour." (at 509)

Furthermore, in *Pawlowski v. Dunnington* [1999] STC 550, the Court of Appeal adopted the following principle from *Dennis Rye Pension Fund v. Sheffield CC* [1998] 1 WLR 840:

> "If the choice has no significant disadvantages for the parties, the public or the court, then it should not normally be regarded as constituting an abuse."

The Tax Tribunals have never gotten this far in the analysis, because they have repeatedly taken a wrong turn at the jurisdiction question. If and when they come to consider the abuse question it is submitted that the reasoning in *Winder* and *Pawlowski* lead to the conclusion that raising public law arguments before the Tribunal is not an abuse of process. In particular:

- The procedure is one that is commenced by HMRC by deciding to make an amendment/assessment (hence why the taxpayer is the "appellant");
- The taxpayer is entitled to raise the defence as of right before the FTT, whereas judicial review is subject to an element of discretion;
- There is no significant disadvantage to HMRC from the tax tribunal procedure – indeed, the time limit for challenging an assessment/amendment is 30 days, which is shorter than the judicial review time limit of three months.
- Forcing taxpayers to fight two sets of proceedings in order to raise both substantive tax arguments and public law arguments is likely to significantly restrict access to justice.
- The supposed informality of the FTT procedure lures taxpayers of more modest means into thinking that they can argue their case without taking legal advice

and thus renders them less likely to be properly informed of their public law options.

- If the taxpayer is not entitled to raise public law arguments in the FTT, he or she must be able to do so in proceedings to collect the tax (where the arguments will obviously be by way of defence), hence the FTT refusing to exercise its jurisdiction ought, in theory, to achieve nothing.

Only, perhaps, where the public law argument is the sole argument before the FTT might it be considered an abuse not to have commenced a claim for judicial review.

It follows that not only does the FTT definitely have judicial review jurisdiction, it should use it.

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WHERE IGNORANT ARMIES CLASH BY NIGHT: HOW REDUCING THE SIZE OF THE STATE HAS INCREASED ITS POWER

by David Goldberg QC

The imposition of taxation involves the State in making demands of the citizen which the citizen is obliged to meet.

There is an inevitable clash here between the Government and the governed: it is more or less certain that each side – certainly as a matter of economics and sometimes as a matter of law – will have different views of how much it is right for any one person to pay; and it is essential, where the dispute is about law, that there is an effective and balanced way of resolving it which does not always require resort to the Courts.

It is, accordingly, important that a system of taxation holds the balance between the State and the citizen in an equilibrium in which neither one side nor the other has too great an advantage.

The difficult and serious question which arises is whether our tax system is doing that: is it properly holding the balance between the State and the citizen?

If that is to be achieved, the State has, as a minimum, the obligation of creating, by legislation, a system of taxation which is reasonably clear and certain, so that, for his part, the citizen can know what obligations are imposed on him and can comply with them without too much difficulty.

Although the question of balance is a large one, I want to start with some apparently small things which I think, reveal something of the true character of the system under which we live.

Let me start with the tax return itself: the form is, of course, prescribed by HMRC.

I do not know how anybody else finds it but, even though it now seems a bit clearer than it used to be, I still find it very complicated and, in places, more or less incomprehensible: I need an accountant to complete it for me.

By contrast, I can fill in my Hong Kong tax return with relative ease.

The tax return form itself tells us quite a lot about the complication inherent in our tax system: if the form is difficult to complete it is because the system is not easy to operate.

However, no matter how complex the tax is, receipt of the tax return form imposes an obligation on the taxpayer which is now governed by the rules of self assessment, which make it necessary for a taxpayer not only to decide what facts are relevant and provide them to HMRC, but also to calculate the tax which is due as a result of these facts.

The move to self-assessment changes the way we think about the tax system in a profound and subtle way: indeed, it does more than just change thoughts; it alters, in a fundamental way, who the primary operator of the tax system is.

The taxpayer is no longer a passive recipient of a demand: he originates the demand and, because that is so, he, rather than HMRC, has an obligation to get things right.

Whether the change was originally intended to have this quite far reaching effect I do not know, but the point that it did was definitely recognised by 2007, when F.A. 2007 Schedule 24 introduced a new system of penalties for errors which clearly puts the burden on taxpayers to get things right in making returns; and, since then, the burden on large corporate taxpayers has been increased by the introduction, in F.A. 2009, of a requirement for there to be a Senior Accounting Officer, who has the duty of ensuring that his company's systems produce a correct tax computation.

And there is more, much more of that kind of thing: there is, for example, expected self policing of the GAAR and of diverted profits too.

This is more than just a change of emphasis: there is here an introduction of a new level of policing. HMRC retain a supervisory jurisdiction and have the penultimate say, but the taxpayer also has a policing function: he must police himself and make a considerable endeavour to get things right.

And here, of course, viewed from the perspective of HMRC, the obligation is not to be right according to the general view of taxpayers, but to be right according to the view of HMRC.

Now that does not sound as if it is too arduous a thing, but, at this stage, it is necessary to think about our tax system in a bit more detail.

In some ways, we have two quite distinct systems of taxation in this country: we have the PAYE system which deals, most often in a relatively straightforward way, with most working people; and we have the rest of the tax system, which deals with companies, large and small, individual traders and partnerships.

Of course, the distinction between the two systems is not rigid or absolute, but, on the whole and, no doubt, subject to certain exceptions (likely to arise with employees paid in kind), the PAYE system works well for a lot of people.

Very broadly, direct tax systems can charge tax by reference to payments made or by reference to receipts.

Our direct system imposes tax by reference to receipts and much of the legislation is concerned with the definition of the taxable subject matter: how much of a receipt is brought into account as taxable?

A payments based tax system is inherently more straightforward than one which is based on receipts, and the PAYE system, although in truth receipts based, gives the impression that tax is a payments based, certain, and simple thing.

That, I rather think, is the impression which most journalists and politicians have of the tax system: it is how, in general, they experience it.

How different, however, is the lot of the person in charge of the tax affairs of a large group, or of an individual who is not an employee, but who has the responsibility of calculating his own tax liability, or of the person whose receipts come to him gross and who has to provide the cash to pay the eventual tax bill, which will almost certainly be unknown at the time of receipt.

Unlike those who are paid subject to PAYE, these taxpayers are faced with some 18,000 pages – 21,000 pages by some counts - of legislation, much of which, though now largely drafted in the apparently simple style of a Janet and John reading primer, is far from clear, and they are expected to distil from this mass a correct tax computation.

Of course, this person may employ the services of an accountant, but, overall, the taxpayers involved may be quite small and the accounting firms may not be large, and both the taxpayer and the accountant will really want to get on with the real business of making money.

The question which arises is whether the burden imposed on the taxpayer by the immense and complicated tax system and the requirement of self-assessment is commensurate: is it a fair balance between the citizen and the State?

It is one thing for a State to say: "These are the facts I need to know. Tell me those facts, and I shall tell you how much tax you owe".

It is another thing for the State to say: "You decide what facts are relevant and then tell me what tax you owe".

The one exercise is relatively straightforward while the other is difficult and less certain.

Of course, a system of self-assessment will be in balance if the complication is recognised and the potential burdens which may be imposed on taxpayers are sufficiently limited.

But I am not sure that our tax system, measured by that test, is now properly balanced, and the lack of balance is not created only by the F.A. 2007 penalty regime, though that is, certainly, a factor.

As is well-known, HMRC have, essentially, a period of one year, following the filing of a self-assessment, in which to open an enquiry into the self-assessment.

If HMRC exercise this right and open an enquiry, the taxpayer's affairs go into what might seem like a period of stasis.

Although the legislation gives the taxpayer the opportunity to seek a closure notice, it seems that, generally, HMRC do not have too difficult a task in resisting an application for a closure notice: the supposed and certainly asserted HMRC need to discover more and more facts is usually accepted as a reason for not ordering closure of an investigation; and the question of whether the need is genuine or not does not seem to be analysed in great detail.

As a result, enquiries opened during the enquiry window can drag on for years and will be supported by the battery of information gathering powers which have, over the years, been given to HMRC.

The use of these powers is not easy to challenge and they can impose very large burdens on the taxpayer which are not always truly necessary.

Moreover, during the period while the taxpayer knows that his affairs are under investigation, he may not know what the supposed problem is, nor may he know what the likely outcome is going to be.

Another feature of this period of enquiry is that, during it, the taxpayer will not actually owe any tax to HMRC other than in accordance with his self-assessment.

Here the current hatred of tax avoidance rears what seems to me to be a rather ugly head.

Although, in the period of enquiry, the taxpayer does not actually owe any tax to HMRC, if he has claimed the benefit of an arrangement registered under DOTAS, HMRC may serve what is called an Accelerated Payment Notice – an "APN" – on him and, in certain circumstances, a Follower Payment Notice – an "FPN" – as well.

These notices require payment of amounts which, apart from the notices themselves, are, where there is an open enquiry begun during the enquiry window, not due to HMRC.

And this demand for payment of amounts which are not certainly due carries heavy penalties if it is not met in short order, with the penalties being non-refundable in some cases, even if the taxpayer is ultimately successful.

There is no right of appeal against notices of this kind: the only possible remedy is judicial review, but, so far, the Courts appear to be unsympathetic to challenges of that kind.

At any rate, in one case where HMRC's claim may be doubtful, an attempt to obtain a judicial review to quash an APN failed at first instance, the judge certifying it as totally without merit and genuinely hopeless – and that, in a case where HMRC's claim is far from clearly right.

APNs and FRNs are not the only cases in which HMRC can demand accelerated payments: astonishingly, they can do it in relation to diverted profits tax too.

The purpose of APNs and FRNs is, of course, to aid the collection of tax: they are to deal with what has been called "the problem of disputed tax".

The identification of disputed tax as a problem ought to be a cause for considerable concern.

For an authority to designate disputes about tax as a problem at least begins to suggest that the authority thinks that disputes of its demands should not be permitted, an attitude that is more suited to the time of the First rather than the Second Elizabeth.

Some systems of taxation around the world provide that, whenever a taxpayer is told by a revenue authority that he must pay tax, he must pay the amount demanded before he can appeal against the claim.

Indeed, we adopt that system here for VAT and, in a certain sense, whenever HMRC make an assessment to the direct taxes because, when that happens, tax becomes due and payable unless payment is postponed.

In the usual direct tax case, payment once demanded is postponed by agreement, but it seems that, where DOTAS arrangements are involved, that practice will no longer hold good, because the overwhelming likelihood is that, in cases like that, APNs will be served demanding payment of the tax.

Again, issues of balance arise.

Because many systems of tax require payment of tax before an appeal can be lodged, it does not seem sensible to say that a requirement to satisfy a tax demand before any dispute about it is resolved is, automatically, unfair.

However, it does seem odd for a taxing authority to be able to demand a payment before it has formulated a claim pursuant to which it requires tax to be paid.

And it seems more than just odd, but also unpleasant, to give HMRC power not only to do that but also to obtain a penalty, if the demand is not paid, in cases where an appeal might seem a sensible course.

The penalties attached to FPNs and APNs are intended to discourage appeals; and that is what makes the method of tax collection introduced by these notices different from the more usual requirement of payment before challenge to any revenue demand.

Somehow or other, in the period starting immediately before the beginning of self-assessment and ending more or less now, we have moved, legislatively, *from* a situation in which nobody owed anything to HMRC, unless and until it was demanded, *to* a situation in which, as a matter of our procedural law, taxpayers have an obligation correctly to assess themselves to tax and carry risks greater than normal, if they have attempted to mitigate tax by using DOTAS arrangements.

No doubt, the payment of tax imposed by law is a matter of obligation, not choice; but is it right for a tax system's procedural law to contain, in many cases, an assumption that amounts are due and payable (so that they have to be paid), without easy recourse to a decision as to whether the substantive law supports the assumption? What thinking leads to the conclusion that that is right?

There seem to be four aspects to the Parliamentary thinking, all of which are probably derived from experience of the PAYE system and the belief it engenders that tax is an uncomplicated certain thing:

(1) the first aspect is a political and journalistic belief that nothing which is called tax avoidance nowadays works or should be allowed to work (especially if it can be described as aggressive tax avoidance);
(2) the second aspect is a widely held assumption that the amounts HMRC demand will actually – and more or less automatically – become due;
(3) the third aspect is the assumption that tax should be collected and appeals should be discouraged in any case where HMRC say tax is due, so that in a very real way HMRC's *ipse dixit* leads not only to the collection, but also to the retention of tax; and
(4) the fourth aspect is the wish to cut down expenditure on administration by the State which, inevitably, moves the cost to the citizen.

There is a tendency in all this towards the concentration of power in the State, and it is coupled with an attempt to disempower the citizen or subject: at any rate, there can be no doubt that the creation of FPNs and APNs and, for that matter, diverted profits tax, increases the power of the State and, inevitably, reduces the rights of man.

However, it does not automatically follow from any of these points that the tax system is going wrong and is moving from the moral to the immoral, from the balanced to the unbalanced.

If the system contains procedural checks on the power of the administrator and if the substantive law is sufficiently clear and certain, even a system which gives the edge to the State so far as initial collection is concerned might be in balance.

In short, the fundamental issue is whether the system provide adequate protections for the taxpayer.

Once the enquiry window has closed, HMRC may only reopen a self-assessment if they make a discovery and satisfy one or other of the conditions set out in TMA 1970 s.29(4) or (5) or FA 1998 Schedule 18 Paras 42 to 45 which, in the jargon of tax, are called deliberate and innocent error.

That is, undoubtedly, at least an apparent protection to taxpayers but, as applied in the decided cases, how real is it?

Now there have been quite a few cases about the effect of s.29(4) and (5), but none of them seem to me yet to have made the essential point about these provisions clear.

The general idea behind self-assessment is that the self-assessment is to stand good unless there is a good reason for challenging it.

It is important, if the tax system is to be reliable and sensible, that the self-assessment should be a solid foundation for the system: a self-assessment needs to have a relatively high degree of accuracy, and that need, no doubt, justifies penalties for error (though whether the penalties we have now are too potentially large or not is another matter).

It is, however, important that *both* sides can rely on a self-assessment: HMRC need to be able to expect it to be right, but the taxpayer also needs to know that a challenge to the self-assessment will be timely and exceptional.

It is, accordingly, not meant to be too easy for HMRC to open a self-assessment outside the enquiry window.

Because that is so, the law is that HMRC must establish that the conditions for making a discovery assessment are satisfied, and on that point HMRC carry the burden.

Now, as I see it, although this is not yet clearly set out in the authorities, the fundamental question in discovery cases is why HMRC did not open an enquiry into the self-assessment within the enquiry window?

If the answer is that HMRC did not, within the enquiry window, have enough information to raise the challenge they wish to raise outside it, then the probability is that they can raise it.

But if, on the other hand, HMRC did have sufficient information within the enquiry window, but missed the point, then they should not be allowed to raise the point.

In other words, the question underlying challenges outside the enquiry window is about fault.

Is it the taxpayer's fault that the point was not raised, because he did not provide relevant information to allow it to be raised?

Or was it HMRC's fault, because they failed to spot a point which was there to spot or because they were too lazy to raise it?

I am not sure that this question of fault has yet been placed as sufficiently at the heart of the debate about discovery assessments, as it should be.

There is another issue about the procedure relating to discovery assessments which is important here, and it goes to the different burdens of proof carried by parties in a tax appeal.

As is well-known, once a substantive tax appeal is on foot, the burden of defeating the substantive claim lies on the taxpayer.

But, as I have mentioned, on the procedural question of whether HMRC are permitted to make the assessment at all, the burden lies on HMRC.

This raises a very important issue as to how a case is to be conducted where there is both the procedural and the substantive issue.

Should the procedural matter be heard separately from the substantive matter?

There are cases in which this is an exceptionally important issue. For example, if it seems unlikely that, on their own and without help from the taxpayer himself, HMRC will be unable to satisfy their s.29 burden or Schedule 18 Paras 42 to 45 burden, the taxpayer may wish them to open the case and call their evidence, so that he can make a submission of no case to answer at the end of HMRC's evidence.

To put that another way, a taxpayer may not wish to allow HMRC to use his own evidence to help them to bring home a charge of innocent or deliberate error.

In a civil trial, a party is not allowed to make a submission of no case to answer unless he elects not to call any evidence at all.

Accordingly, in a tax case, if a taxpayer wishes *both* to make a submission of no case to answer *and* to defend the substantive issue by calling evidence, he must have the procedural case heard separately from the substantive case.

He needs to do that because, if he cannot have the two parts of the case heard separately, he must either abandon the submission of no case to answer, or abandon his right to defend the substantive issue by calling evidence.

It seems to me obvious that, in a s.29 or Para 43 and 44 case, the taxpayer should be allowed to insist on separate hearings of the procedural and the substantive issues: they raise completely different questions and involve different burdens.

Of course, HMRC resist that: they believe that, if the taxpayer fails to show that the substantive claim is wrong, the tribunal will more or less inevitably decide the procedural point in their favour, the taxpayer's failure on the one issue making HMRC's success on the other more likely.

So far the Tribunals have been taking HMRC's side on this issue, but I am still optimistic about the eventual outcome: the taxpayer should be given, in the fullest measure, the protection which s.29(4) and (5) and Paras 43 and 44 are supposed to give him, and I view with distaste the easy willingness with which some Tribunals have allowed this protection to be significantly weakened.

If HMRC do manage to overcome the procedural bar, the appeal against the substantive issue goes ahead as normal.

Going ahead as normal means that, no matter what the nature of the claim to tax, whether it is an assertion that a sum is taxable or the denial of a relief, it is up to the taxpayer to prove the case.

In many ways this might seem odd.

After all, stripped of procedural issues, HMRC are asserting a demand and are, on a realistic view of the facts, the claimant.

General principles would, accordingly, indicate that HMRC should carry the burden of proof.

However, because the machinery of appeal involves a claim by the taxpayer that HMRC's demand is wrong, the burden is put on the taxpayer to establish the negative.

Custom – long custom – makes us used to this, and it does not seem odd to us.

But I have recently learnt that, under most tax systems in Continental Europe, the burden is different: the revenue have to establish that a demand for tax is right, while the taxpayer has to establish that a claim for relief is valid.

That seems to me to involve quite a sophisticated attitude towards the burden of proof which may be superior to ours: in each case, it puts the burden on the true claimant, regardless of procedure

So far, then, I have raised some concerns about whether our procedure is fair, and I have found that other tax systems might, at least in some respects, have a better approach than ours.

But the disadvantage to the taxpayer, inherent in the procedural aspects of our system, will not matter, if our substantive law is sufficiently clear and certain.

In this connection, it is necessary to consider not only the clarity of our legislation, but also the way in which judges apply it.

We often take the *Ramsay* case as marking a departure in the way in which we interpret tax statutes.

However, a proper analysis of the case law shows that the way in which we interpret statutes has not changed markedly over the years: there is not really much to complain about in relation to the purposive construction of tax statutes; it is often necessary and inevitable.

Nonetheless, over the years, something does seem to have changed in the practice of substantive tax, and, if it is not truly the approach of the Courts to the interpretation of statutes, what is it?

I think it is possible to identify five changes in the approach either of politicians or of the Courts which feed off each other.

First, in ways I have demonstrated, there has been a shift in our procedural law; from an emphasis on protecting the rights of the taxpayer to an emphasis on protecting the interests of the State.

Secondly, there has been increasing political disapproval of tax avoidance coupled with times of economic hardship.

The influences, flowing from the economic hardship, include, for example, a restriction on judicial pensions, and that may have fed into the attitude of the judges, who might feel that the restriction on their pensions is, in large measure, attributable to people who have avoided tax.

If that is how judges feel, it is hardly surprising that they do not wish to see tax avoidance succeed.

What makes this aspect of the matter particularly pernicious is that there has not been – largely because there cannot be – any serious attempt to define what is tax avoidance and what not.

There are, no doubt, many people with strong opinions about what is and what is not avoidance, but rational definition seems impossible.

Thirdly, the way in which the Courts analyse facts has become much more elastic than it was, a tendency compounded by the unwillingness or failure of the Courts to set out any rules as to the degree of factual analysis which is permissible or impermissible.

This factual elasticity is the real legacy of the *Ramsay* approach and is highly important: the statute is always relevant in a tax case, but, equally, identification of the situation to which the statute is to be applied is also a constant.

If a statute applies to, say, Saturday afternoons and the taxpayer believes he has created a Saturday afternoon, to be told by the Court that what he thought of as a Saturday afternoon is a banana, will deprive him of benefits which he expected to get.

Since *Ramsay*, courts have been much more willing than they were to say that the facts, when properly analysed, reveal a banana; and they are willing to use a number of devices to achieve that result.

However, there is no clarity as to which analytical devices are permitted and which not, and this, too, contributes to uncertainty in the law.

And, next, there is a rising belief that tax law has a spirit in accordance with which we must all act or face criticism.

Although none of these factors are fundamentally about the rules of taxation, but, rather, are about approaches to the facts and about our attitudes to taxation, they tend to undermine the validity and importance of rules.

We have now enacted, in our GAAR, a rule that, to a very large extent, rules do not matter, because whether something is permitted or not is largely just a matter of opinion.

The GAAR, of course, does not stand alone: we have a host of TAARs and of other provisions, such as the recently enacted diverted profits tax, which, to a lesser or greater extent, create an element of discretion.

We have also enacted provisions which define the taxable subject matter by reference to accounting standards, which are changed quite often and which, in any event, operate by a reference to a supposed substance which will, itself, be relatively changeable.

Accordingly, as our procedural law imposes increasing burdens on the citizen, the administrator's burden is decreased both by the enactment of laws which, to an extent, draw their vitality from outside the Statute and by the enactment of laws which give the administrator an area of discretion.

And this decrease in the administrator's burden is the fifth and, perhaps, worst change of approach, again increasing uncertainty for the taxpayer and the burdens on him.

Overall, these legal and political factors combine together to create a belief that tax is a part of the law of nature and a public view that, to some extent, all moneys belong to the State and the citizen is only entitled to them if he or she can show, in the law, a specific right to them.

On top of that wrong philosophy of taxation, it has also become much more difficult to settle disputes with HMRC, so that a sentiment of envy has seeped into our system and has driven out much needed pragmatism.

The thought that money belongs to the State unless it is shown it doesn't is one of the things that has led to a loss of pragmatism and seems to me to underlie the philosophy of FPNs and APNs and to inform our general political and journalistic understanding.

No matter what the public belief is, tax is an inherently unnatural thing: it cannot exist unless the subject matter of taxation is defined by man written words which will, inevitably, not cover everything and, equally inevitably, will be thought to be right by some and wrong by others.

In short, where tax is concerned, not many people seem to believe in the value of rules anymore; and those who do believe in the importance of rules have recently been quite heavily criticised.

I think that rules do matter: to me, at any rate, it should be obvious, even to a moron in a hurry, that the abandonment of respect for rules leads to a dangerous path on which democracy itself is at risk.

Of course, the problems created by our present forms of political and journalistic commentary will not be solved only by recognising the importance of rules, rather than of spirit.

Rules are not, of themselves, good: there can be bad as well as good rules, and the need is for rules which at least attempt to achieve good purposes, even if, at the same time, we recognise the possibility of failure in the attempt.

We need to recognise that, even if we do not like what the rule says, there is a prime need for the existence of the rule to be recognised and for the rule to be applied.

What I have tried to show, partly by an examination of some of our procedural rules and partly by reference to the ways in which our approach to substantive law has been changing, is that there has been a shift in the balance of the tax system, so that it now quite heavily favours the State rather than the taxpayer.

This is partly as a result of rule change, partly as a result of judge made law, partly as a result of the supposed spirit of the legislation and partly because of a loss of pragmatism: I rather doubt if the rules or the spirit are presently right.

I say that because I have the feeling that the overwhelming direction of our procedural and substantive tax law is that every single penny should be taxed, even if at, historically, what are relatively low rates.

This does not seem to me to be a coherent theme for a tax system, which surely needs a clear underlying philosophy by reference to which the taxable subject matter can be identified and the tax collected in a fair and reasonable way.

Nor do I believe that this is a state of affairs which can or will long continue.

I gave this talk a title which contains the last line of Matthew Arnold's poem "Dover Beach".

In full, the last three lines of the poem are:

"And we are here as on a darkling plain
Swept with confused alarms of struggle and flight
Where ignorant armies clash by night"

As things are, that is quite a good description of how, nowadays, it feels to be a tax practitioner, but, as I say, I do not expect things to stay that way.

I believe that the continuing increase in the apparent power of the State will bring forth a reaction in judges, who will move to restore balance.

Moreover, what I have said relates mainly to cases which involve avoidance.

Avoidance is very hard to describe, but most tax questions are not about avoidance at all: they arise in the context of the efficient structuring of transactions or in the normal course of commercial life.

A large part of the art of tax practice lies in the presentation of a situation so that it cannot be seen as involving avoidance.

Where that happens, everything is much more balanced and the risk of criticism – reputational risk – is almost non-existent.

Indeed, in cases of that kind, I would go so far as to put the matter the other way round.

The person who has a genuine dispute with HMRC and does not fight his corner performs a disservice to the State: fighting for the Right is not a mark of shame but a badge of honour and, as the economy improves, I am confident that Courts will recognise that to be so.

DOES INTEREST ARISE IN THE UK?

by David Goy QC

Section 874 of the Income Tax Act 2007 sets out a variety of circumstances in which tax must be deducted at source when yearly interest is paid. For present purposes the relevant circumstance is when interest is paid to a "person whose usual place of abode is outside the United Kingdom." In all cases the obligation only exists

> "…if a payment of yearly interest *arising* in the United Kingdom is made."[1]

The question of where interest arises is an issue that has been with us for a long time, but limited authority has hitherto existed on the point.[2] Further light has now been thrown on the issue by a decision of the Upper Tribunal in two cases heard together, *Ardmore Construction Limited* and *Perrin*[3] ("*Ardmore*").

The Revenue's view, at least historically is set out in the Savings and Investment Manual[4] where the following is said:

> "Where or not interest has a UK source depends on all the facts and on exactly how the transactions are carried out. HMRC consider the most important factor in deciding whether or not interest has a UK source to be
>
> - the residence of the debtor and the location of his/her assets.
>
> Other factors to take into account are
>
> - the place of performance of the contract and the method of payment;
> - the competent jurisdiction for legal action and the proper law of contract;
> - the residence of the guarantor and the location of the security for the debt.
>
> This list of factors is derived from the leading case on

the source of interest, Westminster Bank Executor and Trustee Company (Channel Islands) Ltd v National Bank of Greece SA (46 TC 472).

HMRC consider the residence of the debtor to be most important because this, along with the location of the debtor's assets, will influence where the creditor will sue for payment of the interest and repayment of the loan. 'Residence' in these circumstances is not the same as tax residence. Residence of the debtor is residence for the purposes of jurisdiction."

The two cases heard in *Ardmore* both involved UK residents paying interest to non-residents where the source of funds, both to enable payment and enforcement, were in the UK. In both cases it was held that the interest paid had a UK source. The UT specifically rejected the argument that the source of interest was where the lender carried on his business and provided the credit. A "multi-factorial approach", was the correct approach, following the House of Lords decision in the *Greek Bank*[5] case.

The *Ardmore* case is interesting because the UT is specific about a number of factors that are either not relevant or have little relevance in deciding the issue. The UT was clear that it followed from the *Greek Bank* case that the legal situs of a debt is not a relevant factor for income tax purposes.[6] It gave no reason, however, why this is the case. Nevertheless, it must now be assumed, that speciality debts, where the speciality is kept outside the UK, will not for that reason alone produce interest arising outside the UK.

Further, based on what was said in the *Greek Bank* case, the UT in *Ardmore* regarded the following factors as of little or no weight:-

(i) The residence of the creditor or the place of activity of the creditor.

(ii) The place where the credit was advanced.

(iii) The place of payment of the interest.

(iv) The jurisdiction in which proceedings might be brought to enforce payment.

(v) The proper law of the contract.

Both (iv) and (v) are factors that the Revenue refer to in their manual as being relevant. The UT disagrees.

Relevant factors that remain are in particular the residence of the debtor, the location of the security and the ultimate source of discharge of the debtor's obligation.

The UT did not follow the Revenue's guidance its stress on the overwhelming importance of the debtor's residence. The UT said that

> "Residence is… only one factor, and it cannot be elevated into the most important factor, whether alone or when combined with the question of the location of the debtor's assets: the *Greek Bank* case did not determine any hierarchy of materiality or weight and none can be inferred."

The problem that this gives rise to is that genuine uncertainty may remain as to where the source of interest is found. In the two cases considered in *Ardmore,* it is not difficult to see that balancing the relevant factors, most particularly of residence and the ultimate source of funds, they pointed to a UK source. But what is the position where important factors conflict? Let us suppose that the debtor is resident in the UK but his only source of funds is abroad? Alternatively let it be supposed that the debtor is non-resident but the source of funds is in the UK. There is a lack of clarity in such cases as to the location of the source concerned. Hitherto it has generally been assumed that if a loan is made charged on UK property, there is a UK source, but it cannot be said that this is entirely clear.

Reliance on the ultimate source of funds as indicating the source of interest may be problematic. Let it be assumed that a non-resident debtor has his only source of funds in the UK, out of which he pays the interest. Clearly this will be a significant factor pointing to a UK source. Let it be supposed that in a later period other sources of income are acquired abroad, out of which the interest is on occasion paid. In these circumstances it would seem odd that the source of the interest could change. The UT's ultimate answer to the question would doubtless be that all relevant factors need to be considered, but this provides little help for the taxpayer who must decide whether he must deduct tax.

One last point arises where both the debtor and creditor are non-resident and do not carry on business in the UK. A question that arises is whether, on *Clark v Oceanic Contractors*[7] grounds, the section 874 procedure, if it might otherwise be held to apply because of there being a UK source, is subject to a territorial limitation based on effectiveness. This is a point not hitherto considered by the courts.

Endnotes

1. S.874(1) ITA 2007
2. The Greek Bank case is the principal relevant authority (1990) 46 TC 472
3. [2015] UKUT 0633
4. SAIM 9090
5. Ardmore para 46
6. (supra) para 45
7. [1983] STC 35

THE OFFSHORE TRUST: A VERY BRITISH INDUSTRY

by Milton Grundy

I remember attending a conference on offshore tax planning – this was some time ago, when "off-shore" was written with a hyphen. The speakers talked about new and exciting things – flee clauses, participation exemption (*non bis in idem*), but – most interestingly – about the offshore trust. This, said one speaker after another, would be the basis of an international industry on an immense scale. In the audience were two men from the Inland Revenue and one from the Foreign Office. The lunch break came. The Revenue men stayed in the lecture hall, talking gravely to each other. But the man from the Foreign Office was in the bar, buying gins.

We do not know to what extent people at the Foreign Office gave general encouragement to the development of the offshore trust industry. Evidently, they did nothing to prevent it. Most of the jurisdictions hosting offshore trusts were (and some still are) British colonies for which the Foreign Office is directly responsible – and they include the Crown Dependencies, which, self-governing as they are, could never have become tax havens if the Westminster government had not wanted them to. My hunch is that the Foreign Office saw the offshore industry as something to be actively encouraged – as a way of preventing bits of the Commonwealth from asking for money. About one such territory I have some inside knowledge.

The Cayman Islands were formerly part of Jamaica. They consist of three small islands between Jamaica and Cuba, some 300 miles North West of Jamaica. Jamaica was a British colony, which became independent in the 1960s. The Cayman Islands had little agriculture and no industry. The territory kept alive by providing seamen for Panamanian-registered ships. The Jamaicans – quite rightly – saw the Islands as a liability, and they persuaded the British to retain them as a colony. The Islands did, however, have one asset. The legend is that a close relative of George III was shipwrecked nearby (whether by intervention of the Islanders or not is uncertain). He was rescued, without, it is said, a drop of salt water to stain his silk trousers, whereupon the King declared that the Cayman Islands should be free of tax in perpetuity. And so they are to this day. They also had a hidden asset – hidden, in the sense that it had not been previously commented on. And that was, that because Jamaica was regarded as settled and not acquired by conquest or treaty (a thesis the history of the matter leaves very much open to doubt), the English had brought their common law with them, including the rules of equity, so that the concept of the trust was already part of the law in Cayman.

In 1966, I was instructed by the Attorney-General in Cayman – there was one, and he doubled as the Judge when required – to draft a trust law. The Governor had obtained the approval of the Foreign Office for the establishment of an offshore financial centre, and he gave me a copy of the trust law of St Kitts, to use as a precedent. I understood that the new Law was to be to some extent a marketing tool. (There is nothing very odd about that: think of Income Tax Act 2007 s.475.) No doubt the main market for the Cayman trust would be practitioners in the United Kingdom and other common law countries. But what about civil law countries? Practitioners there often have difficulty in coming to grips with the concept of a trust: its main shortcoming is that it is not registered. For the civil law practitioner, registration seems to have an ontological significance quite foreign to the common lawyer. The civil lawyer is himself registered. His partnership is registered. His dog is registered. Perhaps he would be more comfortable with a trust if it too were registered. Part VI of the Trusts Law in Cayman would offer the settlor the opportunity to create either a registered trust or an unregistered trust, as he wished.

My draft was enacted by the local legislature, in the form I submitted it, as the Trusts Law 1967, (including a conspicuous, and embarrassing, spelling mistake). The subsequent history of this Law is not part of my narrative. (It led to an amendment of the then Income Tax Act in the United Kingdom, but it is still part of the law of the Cayman Islands, including the spelling mistake, and retaining the controversial and little-understood provisions of section 83).

The Governor also commissioned a companies law – an early version of the later hugely popular international business company legislation in the BVI. With these laws in place, the stage was set for the transformation of an unwanted territory into a spectacularly successful locale for zero-tax trusts and companies. The Governor was less fortunate in his other project, which was to re-establish the turtle in the surrounding waters. He imported turtle eggs from Nicaragua. When the baby turtles hatched, he set them free in the sea, whereupon they all swam back to Nicaragua. But times, and attitudes, have changed, and nowadays many people think turtles should be encouraged to swim where they please, but offshore trusts should be discouraged. Indeed, in the United Kingdom, the ferocious tax regime which affects settlements made by UK taxpayers has led some UK practitioners to dismiss the offshore trust as a yesterday vehicle. But an offshore trust does not have to be a settlement, and the Cayman Islands are now marketing private trusts after the pattern of the unit trust, which are breathing a new life into the offshore trust industry.

THE IMPORTANCE OF BEING NRI

by Nikhil V. Mehta

India's Prime Minister, Mr Narendra Modi, visited the UK in November 2015. He addressed an audience of 60,000 in Wembley Stadium. The event was designed "to celebrate the Indian Diaspora's contribution to the UK economy". This made me think about the different types of Indian taxpayer who would have attended. In particular, I thought about the "NRI" or "Non-Resident Indian", who represents a growing class of individuals spending time in the UK, but, at least until the statutory residence test came in, managing to avoid being UK tax resident. It is not to be confused with second and younger generations who were born in the UK. I am sure both types would have been at Wembley. When the PM began by saying "Good evening Wembley", he could have meant the audience in front of him or the normal population of Wembley, which contains a significant Indian component.

The phrase "NRI" requires some explanation. It is commonly used (and confused) to mean any type of Indian who either has an Indian passport or had an Indian passport, and is not tax resident in India. The Indian test of tax residence for an Indian citizen or person of Indian origin ("PIO") is simple and consists purely of spending 182 days or more in the tax year in India. However, NRI in fact derives its important meaning from India's exchange control legislation, now contained primarily in the Foreign Exchange Management Act 1999 ("FEMA"). Someone who is an NRI under FEMA has considerable advantages in acquiring and holding assets offshore, while not being particularly at a disadvantage in what he can do in India. The FEMA definition of NRI defines residence as a period amounting to 183 days or more in the financial year: this is the same as the tax year and runs from 1st April to 31st March. The quirk that the FEMA test allows one additional day to count towards non-residence than the tax test is important, and the maximum amount a purported NRI should spend in India is no more than 181 days if he wants to be non-resident for tax purpose and an NRI under FEMA. The FEMA test also refers to Indian citizens and PIOs. The status of PIO is, incidentally, something that has to be obtained and is not available automatically. But it is not directly relevant to the current topic. NRIs generally retain their Indian citizenship, whereas a PIO would have a foreign passport. NRI is also an official status: I once innocently ticked the “NRI” box in the immigration form when arriving at Mumbai. My ticking the box resulted in a ticking off by the immigration official since I hold a British passport and relinquished my Indian citizenship many years ago. But since the immigration experience, I have become an OCI, which means “Overseas Citizen of India”; not quite the same as dual citizenship, but I value the fact that I have citizenship status of sorts in both my country of origin and my home country. Unlike NRIs, OCIs tend to be based overseas and only visit India from time to time with no particular regularity.

It is the FEMA status of NRI that carries greater advantages, but achieving non-residence for tax means that the individual only pays tax on Indian income and gains. When I refer to NRI, I refer to an individual satisfying both tests. I should say that pretty much all NRIs are not domiciled in the UK under either the “normal” or IHT definitions.

Historically, the NRI has typically been someone who goes abroad to work for a number of years, visiting India annually. But since economic (including exchange control) liberalisation in 1991, the phenomenon has developed of the NRI being an individual with significant business and personal interests in India leaving to obtain NRI status. Such an individual might well spend up to 181 days in India every year, and the balance overseas. They would retain significant connections with India including home, family and business: unlike the UK, "ties" with India do not affect fiscal residence.

The UK became a favourite location for such NRIs to spend significant periods of time, but in a manner that avoids UK tax residence. Any balance remaining from periods spent in the UK and in India would be spent in a third jurisdiction-or several jurisdictions. The amount of time spent in the UK had a degree of flexibility before the SRT came in. Now, the rule of thumb is not to exceed 90 days a year, but that may be quite restrictive. Some NRIs, before the new proposals for reforming the remittance basis, even opted for UK tax residence from April 2013, relying on the remittance basis to protect offshore wealth. Of course, the combination of non-UK residence and the old capital gains rules regarding disposals of residential property by non-residents gave the best environment for spending time in the UK. Property was seen both as a place to live and an investment, free from Indian regulatory or tax complications and from UK taxes.

The UK has now become very complicated for NRIs. The types of decisions which have to be made include:

Whether to hold residential property individually or in a corporate name (the IHT risk remaining a big factor against individual ownership);

Whether to become UK tax resident in order to maintain quality of lifestyle: for someone who has become resident recently or will do so, there will at least be the 15-year "holiday" for using the remittance basis;

For those who do not want to become UK tax resident, where do they spend the rest of the year after counting days spent in the UK and in India?

Offshore planning for assets which are neither in the UK nor in India. This will of course become of great importance for those who will become UK resident and deemed domiciled in the future;

Whether to stop coming to the UK once an individual has become deemed domiciled under the expected new rule and stay abroad for at least 6 years (or not spend more than the permitted number of days in the UK in those years so as to maintain non-residence);

It has already become the case, with the introduction of the various charges on non-residents and residential property, that no single solution fits every situation. Planning for the future will make customised planning even more important. The challenge for the tax adviser is to produce a strategy which carries sufficient benefits and does not produce an artificial lifestyle for the client.

The one area which has not been explored until now is dual residence and the impact of the tiebreaker clause in the double tax treaty. While it sounds complete anathema that someone who is neither tax resident in India nor in the UK could become resident in both, the "centre of vital interests" test could produce some interesting and beneficial results with careful planning.

A FEW POINTS OF INTEREST

by Laurent Sykes QC

This article sets out a few recent points which the author has found of interest.

A recent case of "time travel"

The recent case of *Bainbridge v Bainbridge* [2016] EWHC 898 (22 April 2016), in which the author acted for the Claimant, shows that it is sometimes possible to travel backwards in time for general law and, in principle also for tax law, purposes. Partners in a farming partnership had transferred land into a discretionary trust giving rise, unexpectedly for the partners, to capital gains tax ("disposal 1"). Moreover the trustees had sold some of that land to acquire new land ("disposal 2", this disposal having been made by the trustees). The trustees leased all of the land they held back to the partners who used it in their trade. The Court agreed that disposal 1 could be set aside under the principles in *Pitt v Holt* [2013] UKSC 26. The Court accepted that disposal 1 could be set aside even where the transfer to be set aside related to land which had been sold by the trustees and which could not be returned to the partners. Instead what would be returned to the partners was the proceeds of sale and anything which those proceeds of sale had been used to acquire, i.e. the new land acquired.

How, after the setting aside (which had retrospective effect), were the various events to be analysed under the general law, taking into account the setting aside? The Chancery Court Master said this:

> "It seems to me, therefore, that the right way to analyse what must be considered in the present case as having occurred, once the transfers into trust are treated as never having happened, is that the original owners have

> retained [the land transferred into the trust], but that the sales (actually by the trustees) are to be imputed to those original owners, as also is the use of the proceeds (in part) to invest in the new land, and (in part) to pay stamp duty, costs and other liabilities of the business."

One consequence of this is that the farmers should be entitled to rollover relief on disposal 2 as they were deemed to have been using the land sold for the purposes of their trade and so to have used the new land acquired with the proceeds. This is an interesting illustration of travelling into the past to re-do things as they ought to have been done, which should be effective for tax purposes.

Corporation tax repayments without a claim

Where tax has been suffered at source a return showing the overpayment will cause a refund to be due without the need for a claim. The *Higgs* judicial review ([2015] UKUT 0092), in which the author acted for Mr Higgs, established that, in a case where tax had been suffered at source, no time limits applied to prevent the taxpayer filing a tax return triggering a refund of tax. This was a case where a notice to deliver a tax return had been served but had not been complied with for many years. In particular, the 4 year time limit in s34 TMA 1970 did not apply to *self*-assessments, as opposed to assessments *by* HMRC. This is now being overridden by new s34A FA 2016, introduced by FA 2016 to deal with the *Higgs* decision. A 4 year time limit also applies to claims.

However, the TMA provisions are mirrored in the Schedule 18 FA 1998 rules for companies (see also *Bloomsbury Verlag v The Commissioners for HMRC* [2015] UKFTT 660). The equivalent of s34 TMA 1970 in the corporation tax context (paragraph 46 Schedule 18 FA 1998) also does not include self-assessments. This is unaffected by FA 2016. The equivalent of s59B(1) which triggered the right to a repayment in *Higgs* without a claim is mirrored, for corporation tax purposes, in s59D(2). The position obtained in *Higgs* (where the 4 year time limit was held inapplicable) would therefore appear to continue to apply for corporation tax purposes since there is no equivalent to s34A for corporation tax purposes.

Continuing relevance of Timpson v Moyes under the new remittance rules

HMRC say in their Remittance Manual (at para 33140): "T, a remittance basis user, donates an amount of money to a Battersea Dogs Home, a UK charity, by making a payment direct to the charity from his US bank account which contains his relevant foreign income. There has been a direct remittance of T's income into the UK; it does not matter that he or any other relevant person does not benefit personally from the money." This is based on the old case of *Timpson v Moyes*.

In the author's view this is not correct (as also pointed out by James Kessler QC in his "Taxation of Foreign Domiciliaries"). In order for there to be a remittance, the property in the UK must be property "of" a relevant person when it is in the UK (unless it is actually the income or gains in question). A bank transfer does not involve the property of the transferor being in the UK. The correct analysis of a bank transfer is set out in the House of Lords case of *Reg v Preddy* [1996] AC 815 which concerned mortgage fraud. Lord Goff said this:

"The question remains however whether the debiting of the lending institution's bank account, and the corresponding crediting of the bank account of the defendant or his solicitor, constitutes obtaining of that property. The difficulty in the way of that conclusion is simply that, when the bank account of the defendant (or his solicitor) is credited, he does not obtain the lending institution's chose in action. On the contrary that chose in action is extinguished or reduced pro tanto, and a chose in action is brought into existence representing a debt in an equivalent sum owed by a different bank to the defendant or his solicitor. In these circumstances, it is difficult to see how the defendant thereby obtained *property belonging to another,* i.e. to the lending institution…..

In truth the property which the defendant has obtained is the new chose in action constituted by the debt now owed to him by his bank, and represented by the credit entry in his own bank account. This did not come into existence until the debt so created was owed to him by his bank, and so never belonged to anyone else."

So no property belonging to the transferor enters the UK and on the example there is no remittance. The same would apply to a gift by the non-dom to an adult child (not a relevant person) from outside the UK.

Limit on income tax for discretionary trust

As a general rule, under s811 ITA 2007 the liability of non-UK resident trustees is limited, in relation to UK savings income (such as dividends), to the income tax deducted at source or to any tax credit on the UK source income. This is however disapplied by s812 where there is a beneficiary who is a UK resident, so that the trustees are liable at the trustee rate on the UK source income in that case.

One situation where a liability for the trustees of such a trust could hitherto be avoided is if the income was allocated to a non-resident settlor under s624 ITTOIA 2005. That is only possible if the income would be chargeable to income tax by deduction or otherwise (648 ITTOIA 2005). It was the case that UK dividend income was chargeable to income tax albeit the tax was limited to the tax credit. So in that case, the settlements regime would apply and the trustees would not be assessable on the income tax since it would be the income of the non-resident settlor under s624 ITTOIA 2005 (albeit the settlor's income tax liability would be limited to the tax credit).

Following FA 2016, dividend tax credits are removed. It follows that any UK dividend income received by the trust is no longer deemed to be that of the settlor. Accordingly, subject to the granting of any interest in possion, the trustees are liable for income tax on the UK dividend income if there is a beneficiary of the trust who is UK resident.

Transactions in securities changes

The recent changes to the transactions in securities legislation effect a number of far reaching changes to the transactions in securities rules. One of the less obvious ones is as follows. Previously, it was, in the author's view, clear that a return of capital which was accounted for as a reduction of share capital or premium in the bottom half of the balance sheet could benefit from s685(6) which stated that the assets transferred on that return of capital would not amount to "assets which are available for distribution by way of dividend by the company". That was so even if there were distributable reserves in the company.

The new s685(7A) which replaces that subsection is expressed in an elusive manner: "The references [to assets available for distribution by way of dividend] to assets do not include assets shown to represent return of sums paid by subscribers on the issue of securities merely because the law of the country in which the company is incorporated allows assets of that description to be available for distribution by way of dividend." In the author's view, this does not prevent amounts which are accounted for as a reduction of share capital or premium being treated as "assets available for distribution by way of dividend" if and to the extent that there are distributable reserves.

This is a view HMRC share. See paragraph 3 of the meeting between HMRC and the ICAEW (Tax Guide 02/16): "HMRC noted their view that the amount potentially taxable under TIS is the amount that could be paid as a dividend, even if a reduction of capital is associated with the actual payment." The Explanatory Notes to the new legislation also state: "It will now be explicit that the assets of a company that are available for distribution are only disregarded where an amount is distributable solely because the laws of the country in which the company is incorporated allow it to be distributed".

Bayliss v HMRC

The recent penalty case of *Bayliss v Commissioners for HMRC* [2016] UKFTT 500, in which the author acted for the taxpayer, highlights the need for a causative link between negligence and the loss of tax in order for a penalty to be chargeable, in that case under s95 TMA 1970. That point seems to have been lost on HMRC following the decision of the First-tier Tribunal in *Litman* [2014] UKFTT 089 where the Tribunal imposed a penalty on the taxpayers who had entered into a scheme on the basis that the taxpayers should have assessed whether the transactions stood up to commercial scrutiny. Un-commercial transactions are not always disregarded for tax purposes however (see e.g. *Mayes* [2011] STC 1269). A penalty is only due if the negligence caused the understatement of tax in the return. In *Bayliss* HMRC argued there was negligence because, for instance, the taxpayer had not kept a full suite of documentation, has signed a sophisticated investor certificate when he was not such an investor, that there were inconsistencies in some of the dates of the documents and on various other grounds. The Tribunal did not consider there to be a causative link between these matters even assuming they were negligent and the understated tax in the return (which was down to more fundamental problems with the scheme in question which the taxpayer had no way of identifying). The taxpayer had moreover taken reasonable steps in assessing whether the scheme worked and whether it had been effective prior to submission of his return and therefore no penalties were due. It is worth noting however the changes to the penalties regime announced in the

August 2016 Consultation Document, making it harder for the taxpayer to rely on the "reasonable care" defence to a penalty.

"Making good" for NI purposes

Where a "making good" payment by the employee has the effect of reimbursing the entire cash equivalent relating to the personal use of that asset, HMRC accept that the provisions of s.10(7A) SSCBA 1992 permit a deduction for the amount relievable for income tax purposes also for Class 1A purposes. The effect therefore is that the making good is wholly effective for eliminating both income tax and Class 1A NIC on any particular benefit.

However if the benefit is not entirely eliminated then HMRC claim Class 1A NI on the full benefit without taking into account any reduction achieved for income tax purposes. It is all or nothing. This is based on the statute which requires, in order for the benefit to be eliminated for NI purposes, that the deduction allowed in respect of "a matter" under the income tax code is "at least equal to the whole of any corresponding amount which would… fall by reference to that matter to be included in [general earnings for NI purposes]". So, HMRC would say that use of an asset if only partially eliminated as a benefit for income tax purposes by a making good of less than the full amount is still fully (and never partially) chargeable under the NI code for benefits.

That may be true as a general proposition but it is still necessary to identify what the benefit is and to distinguish between different "matters". To take an example, the provision of free travel on a number of different occasions are different benefits. If one such trip is reimbursed, the benefit of that particular trip is eliminated for Class 1A purposes also. That benefit is eliminated even if others are not. The legislation looks at benefits on a "matter" by "matter" basis. Each trip is a different "matter" and it would be wrong, as HMRC have been known to seek to do, to conflate them.

APPENDIX I

GITC REVIEW VOLS I-XIII

Index compiled by Paul Connor

Milton Grundy

Michael Flesch QC

David Goldberg QC

David Goy QC

SPV's and Control, Volume XIII, Number 1, December 2014

Miscellaneous Points on VAT and Property, Volume VIII, Number 1, November 2008

Double Tax Treaties and ss.739 and 740 ICTA 1988, Volume V, Number 2, May 2006

Disposals Companies With Substantial Shareholdings, Volume II, Number 1, November 2002

John Walters QC

The View From The Bench, Volume XIII, Number 1, December 2014

The 2009 Reforms of the Tax Appeals Tribunals, Volume VIII, Number 2, April 2009

Individual Residence and s.334, Volume V, Number 1, November 2005

VAT and alterations to listed buildings – the Zielinski Baker appeal, Volume III, Number 2, April 2004

Tax and Damages, Volume II, Number 2, April 2003

Information: Compliance v Confidentiality, Volume I, Number1, November 2001

Nicola Shaw QC

***College of Estate Management v. Customs & Excise Commissioners* [2005] STC 1597: Case Note and Commentary**, Volume V, Number 2, May 2006

Tax and the Proceeds of Crime, Volume II, Number 2, April 2003

Laurent Sykes QC

Four Practical Points to Help Defend Your Client, Volume XIII, Number 1, December 2014

Why Care is Needed in Applying The *Hok* Case, Volume XII, Number 2, January 2014

Capital vs. Revenue: Some Points to Bear in Mind in Disputes with HMRC, Volume XII, Number 1, June 2013

Loans to Participators: A Practical Point, Volume XI, Number 1, April 2012

Domestic Anti-avoidance Provisions: Treaty and EU Overrides, Volume IX, Number 3, October 2010

Residence and Zero Rate of Tax Jurisdictions, Volume IX, Number 2, June 2010

Making Sense of s.809L, Volume VIII, Number 2, April 2009

CFC Code Removed from Statute Book by Judge, Volume VIII, Number 1, November 2008

Nikhil V. Mehta

Foreign Collateral Damage, Volume XIII, Number 1, December 2014

There's no Such Thing as a Sanofi Clause – Or Perhaps There Is, Volume XII, Number 2, January 2014

The Bond and the Short of It, Volume XII, Number 1, June 2013

***Vodafone*, Hydra and Hercules' Second Labour Revisted**, Volume XI, Number 2, December 2012

Vodafone's Supreme Court Victory in India, Volume XI, Number 1, April 2012

Debt Releases Taxing Times for a Corporate Debtor, Volume X, Number 1, March 2011

Growing (Capital) Pains in Indian Taxation and Other Fiscal Ailments for Foreign Investors, Volume IX, Number 2, June 2010

Conrad McDonnell

Schrödinger's Cat, Volume XIII, Number 1, December 2014

The Music Between the Notes: A review of "More Essays in International Tax Planning" Milton Grundy, Volume VI, Number 1, February 2007

Tax and Damages, Volume II, Number 2, April 2003

Michael Jones

A Guide to Some of the Principal Parts of the Offshore Funds Rules – Part III, Volume X, Number 2, October 2011

A Guide to Some of the Prinicipal Parts of the Offshore Funds Rules – Part II, Volume X, Number 1, March 2011

A Guide to Some of the Principal Parts of the Offshore Funds Rules – Part 1, Volume IX, Number 3, October 2010

Tax Planning in Pre-packaged Administrations, Volume VIII, Number 3, June 2009

Every Second Counts: Limits on HMRC's Power to Recover NICs, Volume VII, Number 2, June 2008

Michael Firth

The Magic Behind MTIC (Statistical Reasoning in Tax Cases), Volume XIII, Number 1, December 2014

Tax Superpositions, Volume XII, Number 2, January 2014

The Taxation of Jointly Owned Property, Volume XII, Number 1, June 2013

A Trap for Remittance-Basis Taxpayers: The Situs of Choses in Action, Volume XI, Number 2, December 2012

APPENDIX II

FINANCE ACT 2016

Lecture Summaries by Milton Grundy

Milton Grundy

FINANCE ACT 2016

It is our custom, when each Finance Bill is published, to hold a series of in-house lectures on the principal changes made. Below are my brief summaries of the lectures on this year's Act.

Even the most casual observer may be prompted to ask whether 649 closely printed pages of text is really necessary to update our tax code in a not specially eventful year. It may be said that the prolix drafting is necessary to counteract avoidance, but many tax systems work perfectly well with much less statutory language – in the Netherlands, for example, or Hong Kong, and now that we have a GAAR and umpteen TAARs and that the courts have become implacably hostile to avoidance schemes, one might have thought that the time had arrived for our shelves of Yellow and Orange Books to get narrower, rather than wider.

In the meanwhile, we have to deal with the world as we find it. Somehow or other we all have to get our minds round all this new material, and I hope readers will find these summaries helpful in that task.

Conrad McDonnell

DIVIDENDS: SECTION 5 AND SCHEDULE 1

The dividend tax credit has been abolished. Dividends are now taxed at up to 38.1% with an exemption of the first £5,000.

The entrepreneur doing business through an LLP suffers tax at the top rate of 47% (45% income tax plus 2% national insurance); with a company distributing its profits in full, the shareholders formerly enjoyed a slight tax advantage over the LLP partner, but now he suffers a disadvantage. It is still the case that non-residents have no tax liability on UK dividends.

BENEFITS: SECTION 7
The Section disapplies the 'fair bargain' concept to benefits derived from loans, living accommodation and vehicles. Section 16 and Schedule 3 makes changes to rules applicable to share schemes. Section 17 clarifies the treatment of benefits derived from Restricted Stock Units.

Michael Jones

TRANSACTIONS IN SECURITIES AND DISTRIBUTIONS IN WINDING UP: SECTIONS 34 AND 35.
With rates of corporation tax and capital gains tax at historic lows, it is perhaps not surprising that shareholders in private companies with substantial accumulated profits should be looking at ways of cashing in their holdings and continuing the business in a new vehicle – a transaction given the misleadingly playful name of *phoenixing*. Section 34 amends the transaction in securities rules in Part 13 of ITA 2007 and Section 35 introduces a TAAR to counteract transactions of this kind.

DMF RULES
Many of us thought that the investment manager who could boast that he paid less tax than his cleaning woman came to the end of the road last year. Evidently not. Section 37 amends Chapter 5E of Part 13 of ITA 2007, to enlarge the scope of the Disguised Investment Management Rules as they affect individuals

who perform investment management services, and sections 38 and 39 introduce new provisions covering 'carried interest'.

David Goldberg QC

LOAN RELATIONSHIPS AND DIVIDENDS:
SECTION 49 AND SCHEDULE 7

The Act makes a number of small amendments which are of particular relevance in the context of tax avoidance. As always, the starting point is the profit ascertained in accordance with accounting principles. This rule is well-established, though not one with which the speaker agrees, and these amendments modify the rule in appropriate cases, concerned with non-market loans, transfer prices and exchange gains and losses (these last, in particular, striking the speaker as unnecessarily complicated).

HYBRIDS AND OTHER MISMATCHES:
SECTION 66 AND SCHEDULE 10

These provisions insert a new Part 6A into TIOPA 2010 effectively replacing the old arbitrage provisions. They are intended to counteract tax avoidance through arrangements resulting in a double deduction or in a deduction without a corresponding inclusion. The provisions apply even where the corresponding absence of inclusion or double deduction is in the context of a foreign tax system; the speaker was surprised that we should want to police the tax systems of other countries.

Nikhil V. Mehta

PATENTS: SECTIONS 64 AND SCHEDULE 9

The section amends the present patent box legislation (in sections 357A – GE of the Corporation Tax Act 2010). The benefit is a lower rate of corporation tax on profits from intellectual property. A company can elect in but not out. The new regime restricts the calculation of profits to the "streaming" and "sub-streaming" method and, in order to be BEPS-compliant, it requires a "substantial amount" of the relevant R&D to be undertaken by the claimant. There are extensive provisions for calculating the amount available for relief. The new regime will be phased in between now and 2021.

Laurent Sykes QC

SECTIONS 76 TO 82

The new provisions extend the scope of UK corporation and income tax so that a non-resident will be within the charge to one of the two if dealing in UK land or of developing UK land for the purposes of disposing of it. It does not matter that the income may be non-UK source under general principles and that there may be no permanent establishment, branch or agency and possibly also no trade. The liability is not overridden by double tax treaty protection where a main purpose of the arrangements is to obtain a tax advantage in relation to these taxes, including a tax advantage consisting of treaty protection where this is not consistent with the object and purpose of the treaty (a concept which is not explained).

At the same time the transactions in land provisions are expanded. Some big points are (i) the overriding of treaty relief, (ii) the absence of a clearance, (iii) the removal of the exemption for the disposal of land dealing companies, and (iv) the watering down of the "sole or main object" test to one of "a main purpose". It will often be the case for instance that an investor will have a main purpose of ultimately disposing of the land to benefit from capital growth. Concern has been expressed that this would now be caught and a gain taxed as income.

So there are now even more points to consider when dealing with land, particularly residential land, to include: these rules, the diverted profits tax, non-resident CGT and ATED-CGT.

Michael Firth

ENTREPRENEUR'S RELIEF:
SECTION 86 AND SCHEDULE 13

The changes made to this relief in FA 2015 had "unintended effects", which these provisions seek – retrospectively – to reverse. Fresh definitions of "trading company" and "trading group" are provided and there are rules dealing with joint venture companies and partnerships.

INVESTORS' RELIEF: SECTION 87 AND SCHEDULE 14

This introduces a new relief for investors. It applies a 10% rate of capital gains tax to a gain up to £10 million made by an individual on new shares in an unlisted company held for three years. The relief does not appear to apply to joint owners of shares. The shares must be "qualifying" shares – a rule which requires, principally, that the company be a trading company or part of a trading group and the shareholder is not an employee.