THE MAGIC BEHIND MTIC
(STATISTICAL REASONING IN TAX CASES)

by Michael Firth

We’ve all experienced it: the childlike wonder whilst the magician performs an impossible feat, followed by a few moments trying to work out how it was done, and then an acceptance that the clue was in the name: it was magic.

The aim of a magician is to produce the apparently impossible or hugely improbable at will. Whilst some tricks operate by way of slight of hand (or, on a grander scale, smoke and mirrors), other tricks play with perceptions of probability: the difference between what the audience perceive as the probability of the effect and the actual probability, as known to the magician.

For example, a magician hands you an ordinary, brand new, deck of cards. He (or she) invites you to rifle shuffle it three times, pick out a card, look at it, remember it and replace it anywhere in the deck. You hand the deck back and the magician tells you what your card was. How did he do it?

To rule out what you are perhaps thinking, he did not look at your card or mark the cards in any way. In fact, until the deck is handed back the magician had no idea what card you chose.

All the information needed to work out how the magic happened is given above – there are no hidden extras or slights of hand. Instead, this is a perception of probability trick.

The starting point is that you were given an ordinary, brand new, deck of cards. That is significant because a new deck of cards comes in a specific order (typically Ace of Spades through to Ace of Hearts). Then you shuffled them – but you didn’t just shuffle them in any old way, it was a rifle shuffle and the significance of a rifle shuffle is that it divides the original
order of the deck into two and then interweaves those sequences. The basic sequence of each half of the deck remains the same, however, within the combined deck.

Thus, looking at a single suite, if the original order is A, 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, J, Q, K, a perfect rifle shuffle will produce A, 7, 1, 8, 2, 9, 3, 10, 4, J, 5, Q, 6, K. An imperfect shuffle may produce A, 1, 7, 2, 8, 9, 3, 4, 10, 5, J, Q, 6, K. Repeating this with a second or third riffle shuffle will mean that there are potentially eight sequences in the deck.²

The magic works because if someone takes a card out of a deck that has been handled in this way, it is very unlikely that they will put the card back in exactly the same place. That card will be out of sequence which allows the magician to identify it. For example, continuing the example with one suite, if the sequence is as follows: A, 1, 7, 2, 4, 8, 9, 3, 10, 5, J, Q, 6, K, it is the four that is out of sequence and must be the one that was selected.

It can be seen, therefore, that what originally looked like a highly improbable feat to the audience – picking the right card out of the deck (1/52) – is actually a matter of high probability for the magician (subject only to the small chance that the card is put back in exactly the same place it was taken from). Once we know what the magician was looking for and why he was looking for it the magic become more of a trick.

The purpose of this article is to explore how differences between perceived probabilities and actual probabilities affect HMRC’s arguments as well as First Tier Tribunal decisions and, potentially, lead them to reach erroneous conclusions. Whilst MTIC (missing trader intra-community fraud) itself is obviously criminal and without any justification, the cases that arise from it are some of the most fact-intensive around and thus provide a good opportunity to investigate how probabilities are treated. It will be seen that certain aspects of MTIC that appear to be magic, unless the taxpayer was participating in
the fraud, are actually explicable on the basis of a difference between perceived probabilities and actual probabilities.

**MTIC (in brief)**

By way of brief background, simple carousel MTIC typically involves:

1. An import of goods (e.g. mobile phones) into the UK.
2. Onward sale of those mobile phones through a number of intermediary companies within the UK (typically referred to as “buffers”).
3. Sale and export of those mobile phones by a trader (typically referred to as a “broker”) to a foreign customer.

The basic VAT analysis is that the importer has a liability to HMRC in respect of its onward supply to the first buffer, the buffers have only a small VAT liability to HMRC (because their input VAT cancels out most of their output VAT) and the broker is entitled to a repayment from HMRC because it paid input VAT to its supplier, but its onward supply is a zero-rated export.

To commit the fraud, the importer of the goods will be paid VAT by the buffer but will disappear without paying it over to HMRC. It becomes carousel fraud when the same goods are imported again to repeat the fraud. HMRC’s response is typically to seek to deny the broker its repayment of input VAT on the basis that the broker either knew or ought to have known that, by its transaction, it was participating in fraud.³

**Circular payments**

In a large number of MTIC cases, HMRC produce evidence which they say demonstrates that the funds passing between traders buying and selling the relevant goods moved, ultimately, in a circular fashion – i.e. the money appears to originate in one company (typically a foreign company), flow through the various traders and end up back in that company (arrows show flow of money – goods flow in opposite direction):
This, they typically say, demonstrates not only that there was an overall scheme to defraud the revenue, but also that the taxpayer (normally the broker) must have known of that scheme because if it did not know who it was supposed to buy from and sell to, the money would not be able to flow in a circle.

The First Tier Tribunal has accepted this reasoning. To take a recent case as an example, in *Honeytel Ltd v. HMRC* [2014] UKFTT 978 (TC), HMRC argued that the evidence showed that there was a mastermind behind the transactions, co-ordinating all of the deals. The Tribunal accepted:

“Everything, in other words, was very plainly pre-arranged and it was clear that the money could not have completed its required circle had there been any chance that any of the parties might have purchased from an entity or sold to an entity, contrary to the planning expectations of the mastermind.” (§52).

“These further deals in accordance with the same pattern [including circular payment] diminish the chance of some incredible coincidence explaining the
role of the Appellant and make it yet more obvious that the only conceivable explanation for the actions of the Appellant must be that the Appellant knew precisely what it was doing.” (§125).

The taxpayer was self-represented and apparently baffled as to how the mastermind could have manipulated it in this way:

“Declan Mundy [director of the taxpayer] periodically referred towards the end of the hearing to the fact that the Appellant had clearly been manipulated to do precisely as it had done, and that he could simply not work out how anybody had been able to achieve this result. He did not seek to advance the unarguable, namely the contention that the steps, including those either side of the Appellant, had been otherwise than pre-planned.” (§54).

In the Tribunal’s words, if the Appellant did not know that it was involved in MTIC, it would be an “incredible coincidence” for the Appellant to have sold to exactly the right customer with the result that the money went in a circle.

Somewhat contradicting its comment that the only conceivable explanation was knowing participation (§125), the Tribunal went on to consider the “conceivable explanation that the parties either side of the Appellant might have simultaneously approached the Appellant” (§132). In response to this, the Tribunal reasoned that such an explanation can only be used once in a deal chain and at other times the Appellant had been a “buffer”:

“Furthermore, with deal chains, the supposition that one particular participant (most obviously the exporter) might have participated by being duped by the parties either side of it can operate only once, and certainly cannot be advanced on behalf of every buffer company. Accordingly, once the Appellant had participated in a number of buffer deals, albeit that we were given no
information about these deals other than that the profits were indeed minimal, this further reinforces the belief that the Appellant simply cannot have remained innocent and ignorant.” (§32).

Before going further, it is only fair to point out that the Tribunal considered a lot of evidence besides the circularity of the payments and its reasoning in that respect will not be analysed here. Returning to the circularity of payments, the Tribunal’s reasoning is relatively simple and prima facie attractive (with significant paraphrasing):

1. Money moved in a circle, time and time again.
2. If the Appellant had not purchased from a particular supplier and sold to a particular customer, the money would not have moved in a circle.
3. It is possible for a “mastermind” to arrange for one innocent dupe in the circle by having companies approach that innocent dupe as supplier and customer respectively.
4. It is not possible for a “mastermind” to arrange for two or more consecutive, innocent dupes in the circle because there can be no guarantee that the first innocent dupe will sell to the second innocent dupe (or, conversely, that the second innocent dupe will seek to buy from the first innocent dupe).

The first thing to note about this reasoning is that it is a statistical argument, based on probabilities. That is, essentially, what the Tribunal was saying when it referred to an “incredible coincidence” at §125. To demonstrate the underlying thinking, consider the following simplified trading environment:

At the bottom are nine offers of goods, say mobile phones, all of those offers are made to Buffer 1, who has three contacts and thus passes them on to Buffers 2(a), 2(b) and 2(c). In turn, those buffers have three contacts to each of whom the offers are passed (referred to as brokers, but they may or may not be exporters).
In the situation under consideration, we know that there is a “mastermind” looking to commit MTIC fraud, and he has arranged it such that an offer of goods is made to Buffer 1, say Offer 1 (i.e. assume Offer 1 is the MTIC offer). The other offers relate to other persons, unconnected with the mastermind.

If we assume that all of the buffers are innocent traders, not involved in the mastermind’s MTIC, then if the mastermind is to involve three layers of innocent traders in his fraud, he (through his foreign company) must correctly choose the one
MTIC deal from amongst the nine being offered by the brokers, apparently without knowing from whom each offer originated (three stages earlier).\(^4\)

Basic probability reasoning suggest that his chances of getting it right are \(1/9\). As a one-off occurrence, such a probability might raise an eyebrow, but it is not an “incredible coincidence” and certainly not inconceivable. However, if time and time again the mastermind appears to be able to correctly choose the right offer, the probability of being able to do that by chance alone drops rapidly. Indeed, performing it twice in a row has a probability of \(1/81\) \((1/9 \times 1/9)\) and five times in a row would have a probability of \(1/59,049\) \((1/95)\). Further, when one takes into account the fact that in the real world there are many more offers and traders, the conclusion that the only conceivable explanation is that the buffers and brokers are in on the fraud starts to look fair.

Unless, of course, there is some magic going on here. After all, it is precisely such a statistically improbable feat that we would expect a magician to perform: correctly telling an audience member which card they chose by chance alone has a probability of \(1/52\); relatively unlikely, but not impossible. Correctly telling three audience members in row which card they chose has a probability of \(1/140,608\) – magic.

It will be recalled that some magic tricks rely on a difference between the perceived probability of an outcome and the actual probability. Exactly the same magical reasoning applies to MTIC: what appears improbable (correctly choosing the right offer, time and time again) is in fact highly probable, when understood properly.

The key point is to focus on how “information” about the MTIC deal can be communicated up the offer chain, without the intermediate traders being any the wiser that they are communicating information about an MTIC deal. In other words, how can the mastermind “mark” his deal, such that he
will recognise it when it pops out of the other end of the legitimate market?

If we assume that all offers are the same, then no such information is communicated and the $1/9$ probability in the simplified trading environment is correct. But there is a lot more to an offer than its mere existence, there is:

(a) the type of good (mobile phone, CPU etc.);
(b) the manufacturer of the good (Intel, AMD, etc.);
(c) the model of the good (each manufacturer makes a number of different models, with different speeds, etc.);
(d) the quantity offered;
(e) the timing of the offer.

What follows from this, is that the mastermind can insert an offer into the legitimate market via an innocent, unconnected party and can be relatively confident of identifying that offer popping out of the legitimate market at some other point because the chances of someone else offering:

(a) exactly that type of good;
(b) by exactly that manufacturer;
(c) with exactly the same model number;
(d) in exactly the same quantity;
(e) at or around the same time

as his original offer, is very small. Indeed, the probability may well become negligible once quantity is taken into account, given the numerous different quantities of good that can be traded in bulk (although some goods come in standard box sizes, partial box sizes are usually possible).

Furthermore, it is a mistake to think that the mastermind has to perform the same trick time and time again from scratch (as the magician does). Once it has been established that, for example, an offer made to Buffer 1 will be passed on to Buffer 2(c) who will pass it on to Broker 8, the mastermind can considerably reduce later searches for his original offer by going straight to Broker 8. Chances are, if the goods have
been offered in that sequence once they will be offered in the same sequence again. In statistical terms, the taxpayer’s participation in the second transaction chain is not independent of his participation in the first transaction chain so it is not correct to multiply the probabilities (see below, in relation to Sally Clark, for more information).

To increase the certainty beyond reasonable doubt, the mastermind can use a “tracer” deal. That would involve using a less common product (for example, a CPU manufactured by someone other than Intel or AMD) for the first offer. This will, by reason of it being less common, make it easier to identify the offer when it pops out the other side of the legitimate market. Once the mastermind has established that goods inserted through Buffer 1 will be offered by Broker 8 (for example), he can switch future offers to more common goods (e.g. Intel), remaining confident that the deal information will still allow him to identify the MTIC offer if/when it is made by Broker 8. For this reason it can be useful to try and identify the first deals in which the taxpayer was involved that were orchestrated by that mastermind (irrespective of which companies were inserted to do the purchasing and selling etc.): if it used a less common good, there was probably a good reason for that, namely, that it was a tracer deal.

It can be seen therefore, that once the magic behind MTIC is revealed, what appeared to be almost conclusive proof of the taxpayer’s knowing involvement in fact becomes nothing more than a lesson in identifying and framing probabilities correctly. Nor is there actually any need to provide evidence that this is how the MTIC mastermind was operating. Aside from that being (presumably) impossible, the premise of the argument was wholly statistical and so it can be rebutted by showing that the statistical premise is wrong.

One final point is worth noting. HMRC typically produce evidence that a very high proportion of brokerage trading in...
the particular good at the particular time was MTIC trading. They use this to support the conclusion that there was an overall scheme to defraud the revenue (i.e. at least part of the chain is fraudulent), but usually there is no basis for saying that the taxpayer was aware of the proportion of fraud in the market. If one assumes, for the sake of argument, that HMRC are right that, say, 90% of brokerage trading in that particular good at the time was connected to MTIC, then in one fell swoop HMRC’s argument relating to circularity has been considerably cut down.

The reason for this is that, if HMRC are right that 90% of trading is driven by MTIC fraudsters, then irrespective of the broker’s knowledge, it is in the region of 90% likely that his customer will be a MTIC fraudster. Once it is almost certain that the customer would be an MTIC fraudster (irrespective of who the broker sold to), the question becomes: how many separate, non-communicating “gangs” of MTIC fraudsters are there operating in that environment? Without evidence on the point no assumptions can be made, and if the correct answer is a small number, then by that logic alone it becomes likely that money will move in a circle: 90% of all trading in this environment is controlled by only a few MTIC fraudsters.

**Prosecutor’s fallacy**

Another statistical trap that lingers in relation to MTIC cases (and, in fact, many cases involving disputed factual evidence) is the prosecutor’s fallacy. Such reasoning is as follows: X has happened; explanation Y (for X) is inherently very improbable; therefore alternative explanation Z is the probable explanation.

The famous example is the case of Sally Clark, who was convicted of the murder of her first two children in 1999. When her first child died, it was treated as arising by natural causes, probably “Sudden Infant Death Syndrome” (SIDS); when her second child also died she was arrested and charged.
There being no witnesses to either child’s death, the prosecution’s evidence consisted principally of expert medical evidence. One expert, Roy Meadows, gave evidence to the effect that the chance of one child in a family dying of SIDS was 1/8543 so the chance of two children in the same family dying of SIDS was about 1/73m (1/8543 x 1/8543). Professor Meadows also tried to give some context to this statistic:

“it’s the chance of backing that long odds outsider at the Grand National, you know; let’s say it’s a 80 to 1 chance, you back the winner last year, then next year there’s another horse at 80 to 1 and it is still 80 to 1 and you back it again and it wins. Now here we’re in a situation that, you know, to get to these odds of 73 million you’ve got to back that 1 in 80 chance four years running, so yes, you might be very, very lucky because each time it’s just been a 1 in 80 chance and you know, you’ve happened to have won it, but the chance of it happening four years running we all know is extraordinarily unlikely. So it’s the same with these deaths. You have to say two unlikely events have happened and together it’s very, very, very unlikely.” (R v. Clark [2003] EWCA Crim 1020 §99)

His first mistake was similar to that discussed above: multiplying the probability of one SIDS death by itself to find the probability of two SIDS deaths. It is only appropriate to multiply the probabilities of two events to establish the probability of them both happening if the two events are independent. Two events will not be independent if, for example, there is an underlying cause which causes them both. In relation to Sally Clark the cause of SIDS was unknown and thus, for example, it could have been a genetic defect that was being passed on to both children. In relation to circular payments in multiple chains, the events are not independent, because once it is established that offers flow in a particular way through the legitimate
market, they are likely to do the same the next time.

The second mistake is the prosecutor’s fallacy. Essentially, the expert’s reasoning was as follows:

- Two children in the same family died in separate incidents.
- There are two possible explanations - an innocent explanation (two SIDS deaths in the same family) and a guilty explanation (murder).
- The innocent explanation is highly improbable, therefore the guilty explanation must be correct.

The error is to think that the probability of the guilty explanation is the inverse of the ex ante probability of the innocent explanation (which, in the circumstances, would be understood as 72,999,999/73m, i.e. certainty for most practical purposes).

To understand this, it is necessary to understand what the probability relates to. The 1/73m relates to the probability before any deaths occur that in a particular family, there will be two deaths caused by SIDS. Similarly, before any deaths occur, one could consider the probability that the mother would murder her first two children on separate occasions. Research is not required to say that that too is an unlikely event. Let us assume it is equally improbable (1/73m).

Ignoring any other causes, we can conclude that any given family, without any additional information, has a total probability of 2/73m of experiencing two infant deaths.

Occasionally, however, it will happen. After it has happened, one is essentially considering two highly improbable causes for the event that was, itself, highly improbable; but one of them must be true. If one wishes to use statistical reasoning, the correct approach is not to look at the ex-ante probability of the innocent explanation, see that it is highly unlikely and conclude that the other explanation, whatever it is, must be right. Instead, it is to compare the relative likelihood of all the possible ex-ante causes. On the premises adopted here, the innocent and guilty explanations have equal ex-ante probability,
so on the available information one cannot conclude that either explanation is more likely than the other.

In more formal terms, the analysis needed is Bayes’s theorem, which allows one to separate how likely alternative explanations are for an event that has happened from how likely it was that that event should have happened in the first place:

The equation is easier to understand than may first appear. Essentially, we are trying to work out the probability of our hypothesis (H) being correct in light of some new piece of evidence (B), i.e. Prob H given B.

As you might expect, we start with the probability of our hypothesis (H) being correct ignoring piece of evidence B (i.e. initial Prob of H). That is our base point – where we would be if we did not have evidence B – then we apply an adjustment to that initial probability based on piece of evidence B.

The adjustment is contained in the fraction. A probability of 1 is certainty. So if we assume that it is certain that we would find piece of evidence B if our hypothesis is correct (i.e. Prob of B given H = 1), then our adjustment is inversely linked to the general probability of B (ex ante Prob of B). In other words, the rarer piece of evidence B is, generally, the more likely our hypothesis becomes as a result of finding evidence B.

Thus, for Sally Clark, the hypothesis is that she committed double murder of her children, and the piece of evidence is the deaths of her two children. The initial probability of Sally Clark having committed the double murder of her children, without knowing whether her children are dead or alive is, on the assumed premises, 1/73m – very unlikely.

Then we adjust for piece of evidence B, namely, that her two children are dead. The probability of the two deaths occurring if our hypothesis (that she committed double murder) is correct is certainty, i.e. 1 (there is no more to this than appears – if she committed the double murder of her children then we would always expect to find that her two children are dead).
So it all turns on how generally prevalent the death of two children in the same family is. If the probability of two children dying is equal to the probability of double murder, then we would conclude that it is certain that our hypothesis is correct – double murder explains all the double deaths we see. Further, given that we are certain to find two deaths if our double murder hypothesis is correct, we can never have a smaller probability of double deaths than our initial probability of double murder.

In fact, we know that there is another cause for such double deaths: SIDS; so the probability of two deaths is higher than the probability of double murder (some double deaths will be caused by SIDS and not murder). Assuming, as we are, that SIDS and double murder have the same initial probability \(1/73m\), the general probability of double deaths is \(2/73m\) \(1/73m + 1/73m\).

Pulling this all together, the probability of our hypothesis (double murder) being correct in light of there having been two deaths is:

In other words, if the only fact we have is that two children died, we can only say that it is 50% likely that it was due to double murder.

There is a very good example of the prosecutor’s fallacy in tax cases (aside from MTIC, on which see below); the case of *Joseph Okolo v. HMRC* [2012] UKUT 416 (TCC). Essentially, the taxpayer submitted self-assessment returns declaring self-employment income from a business of property development. Turnover disclosed was high, but expenditure meant that only a small taxable profit was left. HMRC investigated and issued closure notices on the basis that there was no evidence to support the expenditure (leaving the turnover intact). The taxpayer’s explanation was that he had submitted entirely fictional tax returns (i.e. there had never been a property development business) as part of a scheme to create a false impression of a substantial trading history in order to improve his ability to obtain loans.
At the FTT, Mr Okolo lost because the FTT found it:
“…wholly improbable that the appellant would have made up such an elaborate lie for the first reason that he has given [to obtain a loan]…
“We find it beyond credence that the appellant would have overstated his income knowing that that would result in him having to pay tax on sums which, according to him, he did not earn.” (§§16 – 17).

In other words, the (semi-)innocent explanation was highly improbable (that he had lied in order to boost his creditworthiness) so the guilty explanation should be accepted (or, at least, the Appellant had failed to discharge his burden).

This was an impermissible inversion of probabilities. The low probability that someone would submit false tax returns in the hope of getting a loan does not provide any grounds, of itself, for rejecting that explanation or attaching a high probability to the turnover being real.

Fortunately, on appeal, the Upper Tribunal corrected this error:
“I agree with the tribunal that, at first blush, it appears implausible; but I agree with counsel for Mr Okolo that the alternative is even more implausible”. (§33).

The alternative was, inter alia, that Mr Okolo, a person with no apparent experience of the building industry and employed full-time in a completely unrelated sector, should have carried on a substantial and highly profitable contractor’s business in his spare time; that the turnover of that business should have been generated entirely in cash and the profits hidden in some unexplained manner (§32).

Returning to MTIC, the way HMRC typically present the argument is that the mastermind would not be able to cause the money to flow in a circle without the taxpayer’s knowing involvement; money moved in a circle, therefore we can infer knowing involvement. If it was an actual impossibility for
money to flow in a circle without the taxpayer’s knowing involvement, the logic would be sound: there is no other possible cause. In fact, this is not true (one possibility is knowing involvement, the other is that the mastermind correctly identifies the MTIC deal by chance) and the highest HMRC can really put their argument is that it is highly unlikely ("an incredible coincidence").

Once that is recognised, we can see that their argument inverts the probabilities (i.e. makes use of the prosecutor’s fallacy): the probability of circular money flows without knowing involvement is very low, therefore the probability of knowing involvement is correspondingly high. What is missing is a consideration of the initial probability of the hypothesis, namely that this person has knowingly participated in MTIC fraud.

Picking up the Bayes way of thinking (i.e. the correct way of thinking) we need to first work out what the initial likelihood of our hypothesis is, i.e. the taxpayer being knowingly involved in MTIC fraud (initial Prob of H). Depending upon the other evidence available this may be higher or lower than the general probability that a person caught up in MTIC was knowingly involved.

Next, to take account of our new piece of evidence (circular payments), we multiply by

We can assume, for present purposes, that the probability of circular payments if T is knowingly involved is 1.

So what we find is that the effect of circular payments on our initial confidence in our hypothesis (knowing involvement) depends on the general prevalence of circularity in MTIC deals. If, as explained above, there is a mechanism whereby the mastermind can correctly identify his MTIC deal with or without the taxpayer’s knowing involvement, then the general probability of circular payments in MTIC could be expected to be 1 and the existence of circular payments has no effect on our confidence in our hypothesis.6
If the general probability of circular payments is less than 1, our confidence in our hypothesis increases inversely in proportion to that general probability. Thus, if the general probability of circular payments is 10/11, then we increase our confidence in our hypothesis by 10%.

Whilst the above is specifically in relation to circular payments, the same way of thinking applies to all the evidence that is presented to the Tribunal: identify initial confidence in hypothesis, adjust to take account of new evidence.

Furthermore, a vital point is to avoid the prosecutor’s fallacy in relation to the overall conclusion. One sometimes sees reasoning that looks suspiciously like: “pieces of evidence A, B, C and D would, taken together, be extremely unlikely if T was not knowingly involved, therefore it is very likely T was knowingly involved”. In such reasoning there is no apparent consideration of the initial likelihood of the conclusion, before taking account of such evidence, and a proper conclusion must take into account the countervailing evidence – the evidence that makes the hypothesis less likely. There is no probability, barring certainty, that renders it unnecessary to at least consider the evidence pointing in the opposite direction.

Conclusion

The purpose of this article has not been, in any sense, to encourage the use of complex mathematical calculations in tax cases. Sometimes such calculations may be appropriate, often they will not.

Instead, the purpose has been to encourage critical reflection on the way we think about and assess probabilities when factual issues are disputed. Thus:

(a) We should be resistant to simply accepting assertions that something is very unlikely – it may be very unlikely, but we need to consider what the underlying mechanism that
makes it unlikely really is, and whether there might be some complexity we are missing.

(b) We should always be suspicious of attempts to argue “explanation X is unlikely, therefore, alternative explanation Y is likely”. It has an intuitive appeal, but as a general proposition it is wrong.

More often than not we do follow these rules without deliberately thinking about it, but we cannot and should not conclude from this that we always do. Magicians are a constant reminder that the probable can turn up dressed as the improbable:

“One of the best-kept secrets we have as magicians is that laymen would never imagine we would work so hard to fool them.”¹⁰

MTIC fraudsters are criminals, not magicians (although the two are not mutually exclusive), but HMRC, the Tribunals and innocent taxpayers should not underestimate the lengths they went to to fool them and to achieve their purpose.¹¹

Endnotes

1 See further Fooling Houdini by Alex Stone, in particular at page 253.
2 Indeed, a pack of cards only becomes substantially random after seven rifle shuffles.
3 Kittel, ECJ, C-439/04.
4 Note that the risk that someone other than the intended foreign customer will buy the MTIC goods is not really a risk to the mastermind (assuming the goods are genuine): that legitimate person’s money flows up to the importer, who defaults and the fraud is complete as normal. The problem with committing MTIC fraud in this way (i.e. relying on demand from the legitimate market) is that once legitimate demand is saturated, no more MTIC can be carried out. By posing as a foreign customer, the mastermind generates artificial demand (but does not have to pay VAT itself, because the export to the foreign customer is zero-rated).

What the mastermind does not want to do, however, is to buy someone else’s goods for export, as that would mean money does not flow up to
the mastermind’s importer and there is no opportunity to default. The problem to be solved is thus one of the mastermind avoiding purchases of non-MTIC goods.

5 There is a more complicated way of reaching this conclusion, which is contained in some representations of Bayes theorem. The general probability of double death (“B”) is:

The first stage presents no difficulty: the probability of a double death if our double murder hypothesis is correct is 1, and the probability of our hypothesis being correct without being aware of B is 1/73m.

The second stage requires care. The probability of not H is the inverse of the probability of H (i.e. 72,999,999/73m), however the probability of B given not H is not 1/73m, it is 1/72,999,999.

This is again slightly counterintuitive – why does assuming there has been no double murder (i.e. not H) increase the probability of a double death due to SIDS? The answer is that within a sample of 73m mothers we would expect to see one double murder and one double SIDS. If we exclude the instance of double murder we exclude one instance where there has been no SIDS and our sample size decreases by one.

By way of analogy, consider the chances of rolling a dice and obtaining an even number if the dice does not show a 4. There are three causes of an even number: 2, 4 and 6. Initially, each has a probability of 1/6. By excluding the possibility of a 4, however, the probability of each cause increases (to 1/5 – there are now only five possibilities 1, 2, 3, 5, 6) even though the overall probability of the even outcome decreases.

6 The mastermind may or may not want circular payments in a particular case. However, once it is established that the mastermind can choose to have circular money flows even if T is not knowingly involved, then there is no reason to think that he would abstain from circular payments more often in cases where T is not knowingly involved as compared to where T is knowingly involved. Thus, one would have to revise the assumption in the numerator (that the probability of circular payments if T is knowingly involved = 1) by the same amount, with no overall effect.

7 \(1/(10/11) = 11/10\) which is the same as multiplying our initial probability by 110%.
As long as correct reasoning is followed, it does not matter in which order one takes account of evidence: an increase in confidence in the hypothesis of 10% followed by a decrease of 40% is the same as a decrease of 40% followed by an increase of 10%.

In fact, the Court of Appeal has rejected the very concept of using probabilities to refer to past events as “intrinsically unsound”:

“The chances of something happening in the future may be expressed in terms of percentage. Epidemiological evidence may enable doctors to say that on average smokers increase their risk of lung cancer by X%. But you cannot properly say that there is a 25 per cent chance that something has happened: *Hotson v. East Berkshire Health Authority* [1987] AC 750. Either it has or it has not. In deciding a question of past fact the court will, of course, give the answer which it believes is more likely to be (more probably) the right answer than the wrong answer, but it arrives at its conclusion by considering, on an overall assessment of the evidence (i.e. on a preponderance of the evidence), whether the case for believing that the suggested event happened is more compelling than the case for not reaching that belief (which is not necessarily the same as believing positively that it did not happen).” (*Nulty v. Milton Keynes BC* [2013] EWCA Civ 15 at §37).

This went far further than was necessary to decide the case in front of it, apparently amounts to a rejection of Bayes theorem and is inconsistent with basic notion that something being “more likely than not” is expressing a view on the probability of a past event, albeit not in specific percentage terms.

Jamy Ian Swiss quoted in Fooling Houdini by Alex Stone at p.272.

We know that HMRC are perfectly willing to rely on other ways in which the fraudsters tried to fool HMRC, in particular, contra-trading.
Mr. X, who is neither resident nor domiciled in the UK, establishes a non-resident discretionary trust for the benefit of his two adult children, both of whom are UK resident and domiciled. Mr. X transfers £1m. to the trustees, who invest the money outside the UK in income producing assets and accumulate the income. Six months later Mr. X transfers a further £1m. to the trustees, who immediately use the money to purchase a flat in London for the rent-free use of one of Mr. X’s children, Ms. Y.

Clearly Ms. Y receives a “benefit”, as a result of living rent-free in the flat. But is the benefit liable to income tax? In particular, is Ms. Y taxable under section 731 et seq. by reference to the income accumulated in the trust? Rather surprisingly, perhaps, the answer is: No.

And the reason, shortly stated, is as follows. The only “relevant transfer” is Mr. X’s first settlement of £1m. It is that transfer, together with the “associated operations” relating to it, that results in income becoming payable to the non-resident trustees: see sections 716(1) and 719. But the benefit to Ms. Y is not “provided out of assets which are available for the purpose as a result of” that first transfer/associated operations: see section 732(1)(a)-(c). The benefit is provided out of Mr. X’s second transfer of £1m. (plus the related associated operation) – and that second transfer/associated operation never generated any income. The key point to notice in this connection is that Mr. X’s second transfer of £1m. is not an “associated operation” in relation to his first transfer of £1m.: see again the definition of “associated operations” in section 719.

It should, however, be noted that if Mr. X’s two transfers of £1m. had been made by a single disposition, or in circumstances where they constituted a single ‘Ramsay
transaction’, then Ms. Y’s “benefit” would be taxable under section 731 et seq. Similarly, Ms. Y would have a tax liability if any part of the £1m. first transferred by Mr. X was used to maintain or repair the flat.

But subject to these considerations the non-taxability of Ms. Y’s benefit appears to be incontrovertible. The point is not a new one. It is referred to in a number of the text books. But it is surprising how often the point is overlooked: and it can often be relevant when considering the UK income tax implications of an offshore settlement to which there have been multiple transfers.5

Endnotes
1 Mr X is not troubled by the potential 10 year anniversary IHT charge. The flat will be sold before then.
2 All statutory references are to the Income Tax Act 2007 unless the contrary is indicated.
3 Readers can assume that the exemptions in sections 737 to 742A – no tax avoidance purpose etc. – will not apply.
4 The position might arguably be different if the wider IHT definition of “associated operations” had been used: see section 268(1)(b) of the IHT 1984.
5 If Mr X had sought advice from GITC prior to his second transfer of £1m. he would have been advised to make a new, separate settlement. But then this article would never have been written!
THE SENIOR ACCOUNTING OFFICER
by David Goldberg Q.C.

When a while ago now, I was asked to talk about the role of Senior Accounting Officer and the difficulties inherent in it, I, of course, said that I should be more than happy to do that, even though, before then, nobody had asked me anything at all about the role of the Senior Accounting Officer.

I was, I think, vaguely aware that such a post existed, but I had certainly not studied the legislation and I was not aware of the practical problems which are being encountered.

Accordingly, I came to the topic as something of a noviciate, and I find that, in FA 2009 Schedule 46, there are four or so pages of legislation, which is then supplemented by what, in my printed version, is 104 pages of guidance.

It is worth noting the word “supplemented”.

When I started in practice we discovered what the law was by reading the legislation.

What was said outside the legislation was more or less irrelevant, and, had the law remained like that, it would have been completely wrong for me to make the statement which I have just made – that the legislation was supplemented by the guidance.

But these days we take account of all sorts of things in interpreting legislation, and this is one of the things that has made the law less certain than it used to be and less certain than I think it ought to be.

I have no doubt whatever that, if a judge finds in the guidance something which supports the view he wishes to take, even though that view might not be reflected by the legislative wording, he can say that he is bound to come to that view because he must take the guidance into account in interpreting the legislation.
However, if the judge doesn’t like what the guidance says, he can more or less always find an excuse for ignoring it.

For my own part, I regret this laxity in the law: it is undesirable; at best it creates a degree of uncertainty, and, at worst, it gives an unchecked legislative power to unelected administrators. I also think that good legislation should not need explanation and certainly not by guidance 10 or 20 times its own length.

I mention all this because I think the explanatory role of the guidance is important in the context of the role of the Senior Accounting Officer: I have, as I shall explain, a concern that the guidance does not accurately reflect but, rather, expands the statutory wording.

Now I am sure that everybody here will be familiar with the statutory provisions and, indeed, with the guidance.

As you will know, this legislation only applies to qualifying companies and qualifying companies are limited to UK incorporated companies of a certain size.

And there are rules about what the size must be and about how you determine the size.

It is interesting in this connection that the rules about when a company is big enough to fall into the SAO regime are, essentially, concerned only with UK incorporated companies – in a time of increasing globalisation, surely that is odd – and that size is determined by Companies Act tests rather than tax tests.

Why the mixing of regimes?

The answer, of course, is that, nowadays, we increasingly link our tax law to accounting and that is, no doubt, why the SAO regime contains a requirement about accounting records and why it refers to the Companies Acts, because that is where the requirements which accounts must satisfy are laid down.

The mixing of law and accounting has not been an unqualified success, but, as this regime shows, we continue to do it.

Although the legislation raises questions of the kind I have
just mentioned, and a lot of the guidance is taken up with examples of when a company is a qualifying company and when it is not, I do not think that this part of the legislation or of the guidance raises any question of particular difficulty, and so I shall not dwell on it.

Once the legislation applies, three duties are imposed by it. Although it is, sequentially, the third duty imposed by the legislation, logically the first duty must be that of the qualifying company itself, to identify, to HMRC, who the Senior Accounting Officer is at any time during the financial year; and there are rules about identifying him which turn on the reasonable opinion of the Company itself.

I doubt if any real difficulty is going to be created by the need to identify a SAO.

The second duty imposed by the legislation is the duty of the Senior Accounting Officer to give a certificate of compliance with the primary duty or to identify failures to comply with the primary duty, and it is the primary duty which, as it seems to me, raises some interesting and difficult questions.

It is perhaps worth noting that the statutory obligation is to give a certificate which states that the Company had appropriate tax accounting arrangements or that it did not. Neither the legislation nor the guidance allows a certificate to say that there were appropriate arrangements except for certain lapses.

If the SAO thinks there are lapses, he must issue a certificate which says the Company’s accounting arrangements were not appropriate, and he must list the way or ways in which they were inappropriate.

However, this duty of the SAO to provide a certificate arises only in the context of the primary duty, so that before the SAO can know what certificate he is to issue he must understand what the primary duty is.

The primary duty is that of the Senior Accounting Officer
and obliges him “to take reasonable steps to ensure that the company establishes and maintains appropriate tax accounting arrangements”; and accounting arrangements are then defined, in FA 2009 Schedule 46, paragraph 14, as “accounting arrangements that enable the company’s relevant liabilities to be calculated accurately in all material respects”.

Now the first question which comes to mind is whether there is really a need for the imposition of the primary duty?

Note that it applies to nearly all types of tax, and not just C.T: for example, it applies to PAYE and to tax liabilities arising from issues of employment related shares, each of which have their own code about disclosure.

I am astonished that companies have allowed this kind of burden to be imposed on their officers without any real objection. I appreciate that the times are not good for claiming that duties in relation to tax are too onerous, but it seems to me that the burden here might be quite heavy.

The second point to note is that the obligation is to have records which enable companies’ tax liabilities to be calculated: it is not, expressly, an obligation correctly to compute a tax liability.

However, the guidance contains examples (for example a calculation of the debits in respect of loan relationships) which suggest that HMRC think the obligation is to maintain records which accurately calculate the liabilities.

And the example about VAT is to similar effect: HMRC seem to expect the records not only to record the item in respect of which VAT was or was not charged, but whether the item is standard or zero rated.

The distinction between a duty to maintain accurate records which enable a computation and a duty correctly to compute is obviously considerable.

For example, in the VAT context, I think that records which accurately record the item being sold enable correct
computation, while records which go further and allocate a VAT rate to the goods sold do more than just enable computation but actually make the computation.

For my own part, I would have thought that the obligation was only to maintain records which made clear how the computations were carried out, rather than records which make the computation, and I believe that, so far as the guidance asks for more than that, it asks for too much.

However, suppose HMRC’s guidance is right, and the obligation is to make, rather than just to enable, correct computation, how do you deal with areas of difficulty – allocation of profit to a taxing jurisdiction (fashionable today politically and with the OECD) or with matters which fall within the GAAR?

Happily for advisers, HMRC seem to hold the view that taking all possible advice ensures that reasonable steps have been taken.

The third point to note is that the legislation contains many references to reasonableness, and, in relation to penalties for failure to comply with the primary duty, there is a double reasonableness test: the SAO’s obligation is to take reasonable steps to establish and maintain appropriate tax accounting arrangements (paragraph 1(1)), but he can avoid a penalty for failing to do that if he has a reasonable excuse for failing to comply with the Schedule (paragraph 8).

These days a requirement of double reasonableness has, apparently, become quite popular and is, no doubt, intended to be reassuring.

However, I am not sure how reassuring it really should be.

As it is up to the penalised person to appeal against a penalty, it seems to me that the burden of establishing reasonableness is, as a matter of domestic law, on the SAO.

And if he has not taken reasonable steps to ensure that there were appropriate accounting arrangements, can he have a reasonable excuse for there not being such arrangements?
I suppose it is possible to imagine situations where there might be a reasonable excuse when reasonable steps were not taken – for example, where there have been changes of the SAO during the year.

But our tax legislation seems to put an increasing amount of weight on a requirement of reasonableness at the same time as our administrative law is recognising that a test based on reasonableness is rather uncertain and unsatisfactory, although I do not believe that it has yet gone so far as to substitute some other more solid test.

Nonetheless, I cannot help feeling that a test based on reasonableness is not satisfactorily certain and, in my view, there are two other unsatisfactory aspects of the legislation.

First, it seems to me that the attempt is to plant into every large UK company someone who might be regarded as an HMRC spy, whose job it is to make sure that the company is aligning its tax reporting with HMRC’s views.

How onerous that obligation is – how much the SAO is like a government spy – must depend, of course, on exactly what the obligation to establish and to maintain appropriate tax accounting arrangements involves.

If HMRC are right in suggesting – as it seems to me that they do in the guidance – that it involves an obligation to produce a tax result with which HMRC would agree, if they themselves made the computation, it is, indeed an onerous obligation.

I very much doubt if the legislation, read literally, does impose an obligation on the company or the SAO to be right, but the guidance is worrying, and I cannot rule out the possibility of a tribunal holding that it does impose that obligation.

Secondly, I should come back to the point that there are penalties for failure to comply with the reporting obligations imposed by the SAO legislation.

The penalties are, in context, relatively modest, but they make the legislation coercive.
As a matter of psychology, this seems to be the wrong approach.

Might it not be better to give a reward for compliance – say a reduction in the tax bill equal to a guess at the costs of testing compliance?

I think people might feel encouraged by legislation in that form rather than, as I suspect they now feel, oppressed by it.
SPV’S AND CONTROL

by David Goy Q.C.

The question whether one company “controls” another is a question that arises in different contexts for tax purposes. Most commonly it arises in determining the availability of the small companies rate of corporation tax where the benefit of the lower rate is reduced if companies are associated. For this purpose companies are associated if one controls the other or both are under the control of the same person or persons. To determine whether this is so the relevant statutory definition is now found in s.450 CTA 2010 where “control” means control at shareholder level. The issue of “control” can also arise in the context of company residence where the historical test has always been that a company is resident where control and management over its affairs is found. In this situation control and management is a reference to control at board level.

The issue of who has control over a company can arise most particularly as regards SPV’s. Companies may be set up for a particular purpose where it is envisaged that they will go along with the wishes of another company or individual. In what circumstances will that other company or individual be regarded as having control over the company in question?

The issue referred to arose recently and was considered by the Court of Appeal in DB Group Services (UK) Ltd v. HMRC. That case involved a scheme to avoid income tax and national insurance contributions on bankers’ bonuses. Instead of bonuses being paid in cash, employees received shares subject to restrictions. An exempting provision had the effect that no charge that would otherwise arise on the lifting of the restrictions would arise so long as various conditions were met, in particular that the company in which the shares were held was not an “associated” company of the company
employing the employees in question. The employer company in that case was the Appellant and the company in which the shares had been issued was Dark Blue Investments Ltd (“Dark Blue”). The company with the ostensible control of Dark Blue was Investec Ltd, which company played a role in administering the scheme and made a market to buy the shares held by employees when they decided to sell them.

HMRC argued that the Appellant had “control” over Dark Blue. Investec Ltd, they argued, simply did the bidding of the Appellant and as a result the Appellant could properly be said to control Dark Blue. This argument the Court of Appeal refused to accept.

In circumstances such as those in issue the Court of Appeal did not lay down any general test as to when it would be correct to disregard the ostensible control of one company and attribute it to another. It certainly did not say that such control will only exist if one person can compel another to act in accordance with its directions. The Upper Tribunal considered that such control would exist if one company could in practice be relied on to act in accordance with the others wishes without giving any independent thought to the merits of any course of action proposed. The Court of Appeal did not expressly agree or disagree with this approach.

The arrangements in DB Group Services involved Investec Ltd acting pursuant to a series of arrangements that were preordained and involved a co-ordinated course of action between the participants. The Court of Appeal said however that

“It does not... begin to follow from this that [the Appellant] was in relevant control of Investec. If A Ltd proposes to B Ltd, an unconnected and independent company, a co-ordinated course of action with a view to achieving a commercial end to the benefit of both, and B Ltd agrees to the proposal and co-operates in its implementation, it is beyond my comprehension why
such state of affairs should be though to justify the inference, that in playing its own part in the operation, B Ltd is to be regarded as being “controlled” in what it does by A Ltd. The proposition is wrong. B Ltd will, by inference, want to take part, and will do so. But there will ordinarily be no basis for an inference that the decisions it makes en route to the ultimate goal will be decisions it makes other than independently and in its own interests, in achieving the proposed end."

A not dissimilar approach was adopted by the Court of Appeal in the earlier case of Wood v. Holden\(^5\) which concerned the residence of a company claimed to be resident in the Netherlands. The company was set up as part of a scheme to avoid capital gains tax. A separate Dutch company agreed to be responsible for the day to day management of the company in question. In taking decisions to buy and sell the relevant shares the Dutch management company followed the recommendations of accountants in Manchester. This fact did not mean that the residence of the company in question was in the UK. Chadwick LJ said the following:

“In seeking to determine where “central management and control” of a company incorporated outside the United Kingdom lies, it is essential to recognise the distinction between cases where management and control of the company is exercised through its own constitutional organs (the board of directors or the general meeting) and cases where the functions of those constitutional organs are “usurped” – in the sense that management and control is exercised independently of, or without regard to, those constitutional organs. And in cases which fall within the former class, it is essential to recognise the distinction (in concept at least) between the role of an “outsider” in proposing, advising and influencing the decisions which the constitutional organs
take in fulfilling their functions and the role of an outsider who dictates the decisions that are to be taken.”

On the facts of the case, Chadwick LJ went on to say that it was insufficient to establish residence in the UK:

“…that the steps taken were part of a single tax scheme, that there were overall architects of the scheme in Price Waterhouse, and that those involved all shared the common expectation that the various stages of the scheme would in fact take place.”

The upshot of what is said in *DB Group Services (UK) Ltd v. HMRC*, and *Wood v. Holden* is that the Revenue will find it difficult to find control in a person other than the person who ostensibly has control unless it can be established that the third party effectively “dictates” what should occur, whether in general meetings or at the level of the Board of Directors. Care must be taken to ensure, that a shareholder’s agreement, if one exists, does not take away “control” from those who ostensibly have it. Even in the absence of such agreement, control may be found in the hands of third parties if those who have ostensible control do the bidding of third parties without exercising independent thought. If shareholders exercising powers in general meeting are not bound to follow any particular course of action, and ultimately consult their own best interests in exercising their powers, then the Revenue will be unable to go behind those ostensibly exercising control to find control elsewhere. This is so even where what is done follows a pre-planned course of action. In establishing corporate residence abroad, so long as directors properly apply their minds to the wisdom and benefits of a particular course of action, control will be found with them.

The decisions of the Court of Appeal in question provide comfort in cases where SPV’s are used, in particular in foreign jurisdictions, whether by groups of companies in the course of managing their general affairs or in cases where such
companies are used for tax purposes. Attempts by the Revenue to go behind those who have ostensible control to find control elsewhere are unlikely to be successful so long as basic rules, as referred to in the preceding paragraph are followed. In this connection, record keeping is important to provide evidence of what and where things have been done. What is vital though is that the underlying reality accords with those having ostensible control in fact exercising that control, not simply and thoughtlessly doing the bidding of third parties.

Endnotes
1 Previously s.416 ICTA 1988.
3 [2014] STC 2278
4 ITEPA 2003 s.429.
5 [2006] STC 443
6 See p.460
7 See p.462
THE OPAQUE PARTNERSHIP: A NOTE
by Milton Grundy

The name I have made up, but the concept is, basically, a traditional one. Generally, as we all know, the way the profit of a partnership is to be shared out between the partners is defined in the partnership agreement – for example, Mr. A is to receive 60% and Mr. B and Miss C are to receive 20% each. But is not unusual for a certain share of the partnership profits – say 30% – to be left to be decided each year, once the results of the year are known, and there may be provision for the appointment of a committee, sometimes called the “Three Wise Men”, with a discretion to decide how this 30% is to be divided among the partners. This division is generally to be done on the basis of an estimate of how much each of the partners has contributed to the success of the business during the past year. But their discretion may be exercised in other ways. I have heard of Quaker partnerships, where the Wise Men are to take into account the personal needs and aspirations of the individual partners. Whatever the nature of the discretion, it of course cannot be exercised until the amount of the profit has been arrived at. It follows that there is always going to be a gap between the date the partnership accounts are made up and the date on which the partners know how much they will each get out of the profit the subject of the discretion. Let us imagine a case where the gap is quite a long one – several years maybe. Now let us consider a case where the whole of the partnership profits are subject to the discretion of the Wise Men. I am calling a partnership in this state “opaque”; because it cannot be truly “transparent” until the entitlements of each of the partners have been arrived at. I can see that if the contributions of the partners to the partnership business were glaringly unequal, the partnership
might be regarded as a “settlement” for tax purposes. But if that is not so, then the question we need to ask ourselves is, “Do any of the partners have any taxable income until the Wise Men have made their decision?” There is the case of Franklin v. CIR (15 TC 464) which throws some light on this question, but really I think it is pure question of fact: either the partner has become entitled to something out of the partnership or he has not, and if he has not, then, unless he is caught by some deeming provision, he does not have anything you can call “income”, and it is hard to see that his partnership share has any value for inheritance tax. It seems therefore that so long as the Wise Men at the partnership level are still making up their minds, the partners have no income and their assets have no ascertainable value, and there does not seem to be any way of taxing the partnership profits.

“This,” one may say, “is not avoiding tax; it is just a postponement. Once a decision is made about how the partnership profits are to be distributed, the chickens will come home to roost”. Well, maybe. Even if that happens, the postponement may itself be worthwhile: if they can invest profitably money which would otherwise be paid to the government, the partners can take the eventual tax liability in their stride. Or perhaps the Wise Men will decide to postpone the decision indefinitely and cause the partnership to buy an island in the Caribbean for use as a holiday retreat. But is there necessarily a tax liability at the end of the day? Suppose the partnership carries on a trade and makes up accounts to 5th April and makes full disclosure of its profits. In year 1, the partnership makes a profit of £x. In year 5, the Wise Men decide that the partnership should distribute the whole of the £x, which is then part of the partners’ income. But the £x is still trading profit of Year 1, and there then appears to be no machinery for assessing it. There is an argument, I suppose, that if the income is in a joint account of the partners, it has
been *received* by them and should therefore be taxed at the basic rate as it arises; that argument does not run in the case of the Scottish partnership, where the income would be received and held by a body separate from the partners.

*Adapted from a presentation made by the author to the International Tax Planning Association in March of this year.*
As a physicist, I am sometimes asked by colleagues to explain Schrödinger’s Cat. The eponymous cat comes up occasionally in litigation (for example, see *Kleinwort Benson Ltd v. Lincoln City Council* [1998] UKHL 38, [1999] 2 AC 349 per Lord Hoffmann at [121]) due to its useful property of being alive and dead at the same time.

Professor Schrödinger (who is an honorary Briton: his grandmother was English and the cat proposition was developed while he was a fellow at Magdalen College, Oxford) intended the cat as a colourful way to explain one of the deep mysteries in science. The mystery is this: very small (quantum sized) objects such as electrons exhibit wave-particle duality. Left to their own devices, they are in fact waves: so they move like waves in ripples, and if enclosed inside boundaries they resonate like sound waves in an organ pipe. If they have several possible places where they can be, then they are in all those places at the same time, in the same way that a wave fans out as it moves along. The human mind, trained by everyday experience (and Sir Isaac Newton) that things are generally to be found in one place at a time and should move from point to point in nice straight lines, rejects this notion and insists there must be some other explanation: the particle must ‘really’ be in one place or the other, we just don’t have a way to know which it is. That is incorrect. The particle really is a wave, it really is in many places at once, at least until something happens to crystallise its position.

In Schrödinger’s experiment (we should emphasise that it was a thought experiment only: had it been a real experiment, that would have been (a) not very kind to the cat, and (b)
potentially difficult to repeat) a cat is placed in a soundproof box. An apparatus is set up where a quantum sized object has a 50/50 chance of being in state A or state B, and the wave theory dictates that the object is in both states at the same time: as a wave, it is in a blend of both states. The apparatus will release poison if it detects the object in state B. Schrödinger posited that the whole system is therefore 50% in state A (where the cat is alive) and 50% in state B (where the cat is not alive) – until the experimenter crystallises the state of the cat by opening the box to find out which it is. This is not a scientific way of saying “we don’t know which of these two things it is”. That is not the point of the thought experiment. The point of it is to try to explain that, at least at the level of the smallest objects, it really is true that they are in a blend of both states at the same time. And if true at that level, then why not also true of the cat, so long as the box remains closed? Or, as Professor Schrödinger wrote, “The psi-function of the entire system would express this by having in it the living and dead cat (pardon the expression) mixed or smeared out in equal parts.”

While Schrödinger, or at least his cat, has now been immortalised, unfortunately, the cat is a terrible analogy for what is really going on in science. Logic, and practical experience, tells us that cats are either alive or dead and so the mind militates against the truth, that the quantum object genuinely is in both states at the same time. Moreover, the thought experiment falsely gives the impression that it is the act of the experimenter opening the box which determines which state the cat is in: it suggests that human beings have some magical property of crystallising quantum states. The proper answer is that the crystallisation happens at an earlier stage, that is the job of the detection apparatus which detects (or doesn’t detect) the object in state B.

Or to put it another way: the cat knows perfectly well whether it is alive or dead.
The scientific mystery remains: what really happens when the state of that small object crystallises? How does it go from being in a blend of both states, to being determined as being in one state or the other? Various explanations have been suggested, none of them truly satisfactory. For example one theory is that each time, two alternate universes are created, one where the experimenter sees the object in state A and one where the experimenter sees it in state B – a thoroughly unhelpful explanation of course, as (a) we are only in one universe, our own, thank you very much; and (b) each of those new universes would split in two again the next time the state of an object has to be determined, and that happens rather often, any time any quantum object interacts with anything anywhere, so that makes for rather a lot of universes.

Lawyers, however – in particular, barristers – have an intuitive understanding of this crystallisation process.

To the barrister, looking at a difficult legal problem, both positions are arguable. The strength of the arguments may vary, but it is rare that a proposition is completely unarguable, and it is not uncommon to have a situation where the chances are evenly balanced as what the correct analysis might be. We develop phrases to convey that: “it could go either way”, “it depends on the judge”, or perhaps best of all “it’s a point for the Supreme Court.” But until that uncertainty has been resolved by the decision of the court — and in a genuine 50/50 case, that of course means the final resolution of the case, as even after a lower tier court has ruled on the question there is a 50/50 chance of reversal on appeal — the true position is not known. Either of the potential analyses can sensibly be said to be correct, that is to say rational, justifiable, arguable, and a reasonable view to hold. It is a good parallel with Schrödinger’s Cat: until you look in the box (by the court making its final ruling) both states are present, that is to say, both have the potential to be the correct answer when that is finally determined.
Clients of course require certainty: commercial decisions must be taken, shareholders must be informed, accounts prepared, tax returns completed, tax liabilities paid. None of these allows for the answer “it’s a 50/50 chance”. Position A or position B must be chosen, even though the reality is that until the answer has been crystallised by the court, it could be either one.

The tax legislation recognises this reality to some extent. So a tax return may turn out to be incorrect, but not unreasonably so. In that event, the taxpayer may be protected from penalties, and may even be protected from the possibility of HMRC raising a discovery assessment if one of two conditions is met, either the tax return was completed in accordance with generally prevailing practice at the time, or the tax return made full disclosure as regards the uncertain matter, that is to say it took a filing position.

In practice this raises uncomfortable questions of degree. The generally prevailing practice defence may apply only if the universal or at least majority view at the time was in favour of Position A: see Daniel v. HMRC [2014] UKFTT 173 (TC), 102 to 112, and there are some indications that that has to be the view of HMRC as well, so that the defence is available only if HMRC’s practice has changed, see Daniel paragraph 121. One type of case where the generally prevailing practice defence is certainly available, however, is where the law has changed: so the tax return was filed on the basis of a settled understanding of the law which has been overturned in a subsequent case. The word “practice” rather than “law” is used because the declaratory theory of law dictates that when the court determines what the law is, it is determining what it has always been, so in theory the law has not changed, only the practice has changed – even though the reality is that the law has changed.

In a case where the position is doubtful, a genuine 50/50 case, the generally prevailing practice defence is therefore unlikely to provide any comfort. But a taxpayer can, in
principle, always protect its position by making full disclosure. Full disclosure for these purposes is disclosure so that a hypothetical tax inspector could reasonably have been expected to be aware that the tax declared in the return was insufficient. A difficult question is whether the disclosure has to state clearly the point on which there is uncertainty, in order to be effective disclosure. *Langham v. Veltema* [2004] EWCA Civ 193, [2004] STC 544 would suggest that the uncertainty does have to be clearly disclosed so that the possible underassessment to tax is drawn to HMRC’s attention, but in that case it was a point of factual uncertainty: there was a range of possible valuations for the property. More recently in *HMRC v. Lansdowne Partners LP* [2011] EWCA Civ 1578, [2012] STC 544, where if there was any uncertainty it was uncertainty as to a point of law, the Court of Appeal indicated (per Moses LJ at [69]) that “awareness of an insufficiency does not require resolution of any potential dispute.” Thus the taxpayer was protected from a discovery assessment by disclosing the facts which were relevant to the position, without drawing to HMRC’s attention what HMRC’s analysis of those facts might be. However it is significant that in that case the actual inspector of taxes to whom the facts were disclosed realized immediately that there might be a tax liability (although HMRC then failed to open the necessary enquiry into the return without the time allowed for that). Moses LJ indicated that in more complex cases, mere disclosure of the facts may not be sufficient protection: he said, “there may be circumstances in which an officer could not reasonably be expected to be aware of an insufficiency by reason of the complexity of the relevant law.”

Since the Finance Act 2014 came into force in July 2014, difficulties in this area have been compounded by the prospect of Follower Notices and Accelerated Payment Notices (APNs). Put shortly, a taxpayer may be disputing his liability to tax, either in an ongoing enquiry or by means of an appeal against
a closure notice in an enquiry which has reached a conclusion – so that in that taxpayer’s case, his liability to tax is not yet crystallised – and may yet be compelled to pay an amount equal to the tax in issue, by means of a Follower Notice or an APN. There are additional criteria which have to be met before these notices can be issued, essentially the arrangements in question have to be a marketed tax avoidance scheme or at least arrangements which have been disclosed to HMRC under the DOTAS rules (which is a somewhat wider pool) but I will not go into those criteria here.

A Follower Notice may be issued where HMRC “is of the opinion” that there is a judicial ruling which is relevant to the chosen arrangements: Finance Act 2014, section 204(4). A ‘judicial ruling’ is defined to include only decisions which have become final, whether because the time for appealing against them has expired without any permission to appeal being sought, or because permission to appeal has been refused, or because they are decisions of the Supreme Court – thus there at least, the statute recognises that certainty is required. However, that impression of certainty is undermined by the language of section 204(4), and the definition of which judicial rulings are relevant, s.205(3) Finance Act 2014, which in practice may give HMRC wide latitude to issue Follower Notices in all cases which in their opinion are covered by a judicial ruling, even if the taxpayer maintains there are grounds for distinguishing his case from that ruling.

APNs may be issued in the case of any arrangements as a result of which a tax advantage is asserted by the taxpayer (for example, by means of claiming relief in a return, or simply appealing against an assessment on the basis that tax is not due), where a designated HMRC officer “determines, to the best of that officer’s information and belief” that the tax advantage does not arise from the arrangements: Finance Act 2014, s.220(5). In a case where there is genuine uncertainty as
to whether the arrangements are effective to save tax or not, or genuine uncertainty about what the outcome of an appeal will be, there is an obvious question as to whether it is possible for the designated officer to determine that tax is due “to the best of his information and belief” at all. That is, there may be cases where the true tax position has not been crystallised by the judicial process, so the only fair view is that the tax position is uncertain: it might be one thing, or it might be the other. How, in that situation, can an HMRC officer properly determine that tax is due, before that has been crystallised?

**Endnotes**

1 At the time, Schrödinger owned a cat named Milton, so we can assume he was in fact fond of cats.

2 Every 11 year old could in fact work this out for himself if he really thought about what his science teacher is telling him. We are taught that atoms consist of electrons orbiting around a nucleus in circles, but also that atoms are spherical: they pack together like balls to make crystals and molecules. If one thinks about it, those two propositions cannot both be correct. If the electrons were orbiting in circles like planets going round the sun, then atoms would be flat discs, or fried-egg shaped. “Aha,” you say, but some of the electrons go in one direction and some in another direction so it all rounds out into a sphere in the end. Unfortunately that is still nonsense. Some atoms only have one or two electrons, but they are still perfectly spherical. The reason atoms are spherical is because the electron is, in reality, in all the different places it can be around the atom, at the same time: that is the only possible explanation.

3 Or, where applicable, “for Luxembourg”.

4 Finance Act 2007, Schedule 24, paragraph 1: a penalty may be imposed only if the return was “careless”

5 Taxes Management Act 1970, section 29

6 Taxes Management Act 1970, section 29(2)

7 Taxes Management Act 1970, section 29(5)
8 See HMRC’s Statement of Practice SP01/09, in particular paragraph 9.

9 *Kleinwort Benson Ltd v. Lincoln City Council* [1998] UKHL 38, [1999] 2 AC 349 per Lord Goff at paragraphs [50] to [54]: in particular his comment that “we should look at the declaratory theory of judicial decision with open eyes and reinterpret it in the light of the way in which all judges, common law and equity, actually decide cases today.”

10 Taxes Management Act 1970, section 29(6)

11 Finance Act 2014, Part 4

12 Finance Act 2014, section 205(4)
I recently came across a word which you don’t see every day, and
that is “de-arrested”. This was used to describe the release of the
jogger who inadvertently bumped into the Prime Minister recently,
and was promptly arrested. On the police accepting the jogger’s
story that he was on his way to the gym, he was de-arrested before
they got to the police station. I could not help dreaming up a
similar verb to describe a change in practice which HMRC
announced on 4th August 2014, and that is the verb “to de-
concession”. To be de-arrested means not to have been arrested
at all, so that no record of the initial arrest can exist. To de-
concession, as will become apparent, means to remove a concession
which probably did not exist in the first place.

The change in HMRC practice relates to the tax treatment
of remittance basis taxpayers (“RBTs”) who take out loans
secured on foreign income and gains (“FIG”). This change
was unexpected, and is not accompanied by any legislative
proposal. HMRC said that their new approach to such loans
will be to treat the receipt of the loan proceeds in the UK as
a remittance of the FIG used as collateral offshore, as well as
to continue to treat as remittances any FIG used to service
interest payments and repayment of principal. So, the same
loan will give rise potentially to two remittances in respect of
a single amount of principal. The change takes the form of
a revised paragraph 33170 in the Residence, Domicile and
Remittance Basis Manual (“RDRM”), as well as a note
announcing the change (the “Note”).

The previous practice
Under their previous practice, published in 2010, HMRC treated
the remittance of the loan proceeds as not constituting a remittance, but treated any subsequent use of FIG to service or repay the loan as a remittance. However, in their previous practice, HMRC reserved the right to tax secured loan proceeds as remittances in “avoidance or non-commercial arrangements” where the loan was not substantially serviced or repaid by the RBT. That did not mean that a borrower who was in the fortunate position of being able legitimately to repay out of clean capital would be caught. It only affected artificial arrangements.

It is worth setting out the relevant extracts from the old RDRM33170:

“Thus there are potentially two possible sources of a taxable remittance charge in respect of the relevant debt - the foreign income or gains used as collateral and the foreign income or gains used to repay the debt.

In the majority of commercial situations, neither party to the relevant debt transaction expects or intends that the collateral offered as security will be taken by the lender. Instead it is planned that the loan will be serviced and the capital repaid without recourse to the security charge. In such cases using foreign income or gains to regularly service or make capital repayments in respect of the relevant debt effectively ‘masks’ the collateral being used. **In such cases the only taxable remittance will occur as and when the foreign income or gains are used to service or repay the loan. The payments, and thus the taxable remittances, will be spread over the loan period.”**

And:

“In some cases, usually involving avoidance or non-commercial arrangements, the relevant debt is not serviced or repaid by the borrower, or only a token amount is offered. In these circumstances the foreign income or gains offered as collateral are being utilised in respect of the relevant debt, that is, to delay or
minimise service charges or repayments. As there is only one possible tax charge in respect of the relevant debt, that is the charge HMRC will take. The charge is taken up-front when the collateral is offered. Such arrangements are expected to be rare.”

Having stated their view that both the provision of collateral out of FIG and subsequent repayment could be separate remittances, HMRC set out the wording in the first extract above. They say that in commercial situations, the use of FIG to service the debt or to repay it “masks” the collateral being used, and thus no remittance arises in relation to the provision of collateral. The word “masks” is attractive, but not very helpful in determining whether HMRC are setting out their view of the law, or whether they are offering a concession. The better view is the former. Certainly, the rest of the extract is quite clear about the treatment in precise language which does not indicate any concessional factors. The last two highlighted sentences in particular appear to encapsulate a view of the law. The language is also consistent with the previous legislative position where something further like a set-off arrangement was required beyond the provision of collateral to give rise to a remittance (see Section V below).

We then have the second extract dealing with uncommercial arrangements, where HMRC reserved the right to tax the provision of collateral as a remittance if they were unable to tax interest payments and repayment of principal. There is in fact no basis for this in the legislation: HMRC cannot pick and choose when a remittance arises in respect of a loan. This may have been one reason why HMRC thought a change in approach was needed.

I do not know if HMRC thought that they were simply following the usual extra-statutory concession practice of setting out the concession, but prohibiting its availability where someone tried to rely on it for tax avoidance purposes. If that
is what they had intended, then the language in the old RDRM33170 did not support them.

**The new practice**
The previous position seemed to be well-settled and justifiable on a sensible reading of the legislation, (subject to the avoidance exception, which was not in the legislation). If a RBT could rely on the practice to avoid a remittance arising when collateral was provided, he would not be particularly concerned about the status of that practice. He may even have been advised that HMRC’s approach was based on a correct application of the law, rather than the granting of a concession. However, in the Note, HMRC state that the old RDRM33170 treatment, published in 2010, was in fact a concession. They go on to say that there had been abuse of the concession, with large numbers of non-commercial arrangements being created where the loan payments and repayments were not made out of FIG, so that no remittance was made to the UK in respect of the loan. To counter this, all borrowers will be treated as remitting their collateral when the loan proceeds are received in the UK. The fortunate borrower who repays his loan genuinely out of clean capital will no longer escape a remittance charge if he has provided collateral out of FIG. He will be taxed on the provision of collateral when loan proceeds come into the UK.

HMRC do say in the Note that the double remittance treatment will only apply where one amount of FIG is used as collateral, and a “different” amount of FIG is used for payments under the loan. Unfortunately, that does not appear in the revised text of RDRM33170; indeed, the word “different” does not feature at all. It might be implied from the Example given in the revised text, where the loan is secured by an offshore bond, and repaid from different FIG in the form of offshore employment earnings. But that is hardly satisfactory. So, in a situation where a RBT has provided FIG as collateral and
subsequently uses that collateral to repay the debt, it may be necessary under the new practice to point to RDRM33170 and the wording in the Note to escape a double charge.

The current law
This of course presupposes that the new treatment is justifiable under the law. The relevant statutory provision is Section 809L of the Income Tax Act 2007 (“ITA”). This section gives us the meaning of remittance. It requires various conditions to be met for a remittance to arise. The conditions applicable to the present subject-matter are Conditions A and B, which must both be satisfied. I only refer below to the relevant parts of each Condition.

Condition A requires simply that any money is brought to the UK by or on behalf of the RBT.

Condition B requires that FIG are used outside the UK (directly or indirectly) in respect of the relevant debt viz. the loan.

The remittance of loan proceeds clearly satisfies Condition A, as all that is required is the receipt of money in the UK. The fact that there is a repayment obligation is immaterial. The critical question is whether the provision of FIG as collateral constitutes use outside the UK of that FIG in respect of the loan.

It is difficult to see how the mere provision of collateral is the use of FIG. “Use” connotes the application of the FIG in a manner which results in a reduction of the borrower’s indebtedness. Repayments of principal clearly fall within Condition B, as do interest payments made out of FIG. In both cases, the borrower’s financial exposure to the lender is reduced by the use or application of FIG to make the payment. It is something of a stretch to say that collateral which remains untouched by the lender is “used” at all. Of course, if there were a default and the lender enforced his security by realising the collateral, that would amount to use of the borrower’s FIG, but only at that point in time.
The previous law

That certainly seems to have been the position under the previous legislation on remittances. Section 833(1) of the Income Tax (Trading and Other Income) Act 2005 (“ITTOIA”) brought into the remittance category any FIG applied by the RBT towards the satisfaction of a debt. That clearly referred to actual payments, and it seems to me that an equally good word in the old legislation for “applied” might have been “used”. In fact, Section 833(1) stated that where foreign income is applied in satisfaction of a debt, a remittance occurs when it is “so used”.

There was a specific category of remittance provided by Section 834 ITTOIA. That applied where a borrower provided a pot of FIG to a lender which could be used to reduce or pay off the debt by set-off or otherwise. It was effectively a way of amortising the loan. In those circumstances, the provision of the FIG to the lender and its retention for set-off purposes was specifically treated as a remittance. Section 834(1) deemed the borrower to be “using” foreign income to satisfy a debt in this scenario.

Both Section 833(1) and 834 types of remittance strongly indicated that the mere provision of collateral could not have been a remittance under the old law. Now, HMRC could quite justifiably say that the old law is irrelevant as the legislation now in the ITA 2007 is a new code for dealing with the remittance basis, and only those relevant bits of ITTOIA which have survived should be taken into account: both Sections 833 and 834 were repealed. But it is still pertinent to ask why the position regarding receipts of loan proceeds was not made much clearer, given the clear contrary position under the old law. It is particularly unsatisfactory that Condition B can, on HMRC’s view, apply both to loan proceeds where collateral is provided, and to the repayment of the loan out of FIG. Indeed, there is nothing in the legislation to say that a double charge cannot arise where the same FIG is used both as collateral, and subsequently to repay the loan. It might, therefore, be
said that the use of the word “different” in the Note, as I have discussed above in Section III, is itself a concession.

If there was intended to be a significant shift from the old law, then the draftsman failed to achieve that in Section 809L ITA.

The proper approach
It seems to me that the proper approach should be as follows:

- The receipt of loan proceeds should not constitute a remittance. It makes no difference whether the loan is secured or not. In the case of an unsecured loan, clearly Condition B is not satisfied as nothing is used offshore on any basis. In the case of a secured loan, the provision of FIG as collateral does not constitute use;
- To the extent that loans are serviced or repaid out of FIG, then that fairly falls within Condition B, and remittances arise at that point in time; the same applies to arrangements like set-off where the loan is effectively amortised;
- If a RBT is able to arrange his affairs so that he is able to repay the loan out of offshore funds which are not FIG, then that means no remittances arise at that stage. He has managed his affairs in an unobjectionable manner: the remittance rules are prescriptive. He has simply followed them, and managed not to make a remittance to the UK;
- There is nothing in the legislation specifically to deal with egregious arrangements. If HMRC want something to this effect, then they need to legislate (assuming they regard the GAAR as insufficient). It is quite unacceptable to impose a potential double tax charge on RBTs on statutory wording which points to a contrary meaning.

Conclusion
HMRC’s previous practice made sense as a matter of law and did not, therefore, need to be concessional. The only grey area was the discretion they gave to themselves to tax
uncommercial arrangements by imposing a charge at the time of receipt of loan proceeds. By choosing now to tax all loan proceeds where FIG have been given as collateral, they have simply magnified the error. What is urgently required is legislation to put beyond doubt that loan proceeds are not taxable, and then to include any appropriate specific avoidance provision to deal with HMRC’s concern. But the latter needs to be crafted in a way that does not catch the bona fide RBT who is able to repay a loan out of clean capital. All that he has done is to remit clean capital to the UK. His position is comparable to the RBT who brings clean capital into the UK without having to borrow anything.

The net result is that the new practice needs to be treated with caution. HMRC’s statements in the Note regarding existing loans and transitional arrangements appear to carry the force of law, but they do not. There are also questions regarding HMRC’s conduct to be answered, and yet again we have the issue of how much reliance can be placed by a taxpayer on what is in the Manuals. But the unusual substantive position is that HMRC implemented two steps, which they viewed as the grant of a concession, and then its recent removal. Both steps are, in my view, based on a misapplication of the law, since the content of the apparent concession was in fact good law. Therefore, the old practice has been “deconcessioned”.

Two wrongs don’t make a right. Where does this leave the affected taxpayer? There are a number of reasons why I do not think he is bound to follow HMRC’s revised view and, on a more practical basis, to comply with HMRC’s notification requirements for existing loans.
FOUR PRACTICAL POINTS TO HELP DEFEND YOUR CLIENT
by Laurent Sykes

No-one is perfect (not even HMRC), and sometimes taxpayers fail in their obligations. Here are some important practical arguments for the taxpayer to have in mind in such circumstances.

Point 1: Failure to notify chargeability
On the face of it, 20 year time limits apply under s36 TMA 1970 where there has been a failure to notify chargeability even where there has been no “deliberate” conduct.

However, s118(2) TMA 1970 says that, where a person had a reasonable excuse for not doing anything required to be done, he shall be deemed not to have failed to do it provided, once the excuse ceased, he did it without unreasonable delay.

This is a mouthful, but the point is, if the taxpayer can establish a reasonable excuse for failure to notify chargeability (bearing in mind ignorance of the law can in some cases be a reasonable excuse), time limits can be halted. This is an argument which HMRC have in the past accepted.

A typical example may be an individual who does not realise that he is viewed as UK resident. HMRC may seek to go back 20 years. But using S118(2) could shorten this period to just 6 years and potentially 4.

Similar principles apply to trusts and, under FA 1998, the same rule is brought in to also apply to companies which fail to notify of their chargeability to corporation tax.

Point 2: No need for a reasonable excuse
HMRC may be obliged to extend a statutory time limit or deadline if the result of not doing so would amount to a
disproportionate interference with the taxpayer’s rights to their own property. A reasonable excuse is not necessary.

That HMRC do have a general discretion to extend time limits in case of hardship is recognised by both them and the case law (see the Wilkinson case). The dispute arises as to when the discretion should be exercised. Where the interference is disproportionate, then, as a public body, HMRC must exercise their discretion to prevent this. Proportionality is moreover to be judged in light of the impact on the specific taxpayer and not in the abstract (see the Total Technology case). It follows then that an extension does not always depend on showing an absence of any blameworthiness by the taxpayer.

**Point 3: Reasonable excuse – factors to be considered**

Where the legislation allows for a reasonable excuse to avoid a penalty, what constitutes a reasonable excuse is a matter of statutory interpretation.

If the Act provides for taxpayers to be given a reminder before the sanction is imposed, then it would be treating taxpayers unfairly if the taxpayer who was not provided with the reminder should be put in a worse position because of HMRC’s failing to give that warning. An example is the oft-ignored obligation on HMRC to notify the taxpayer that a tax-geared penalty under Schedule 56 FA 2009 has been incurred as soon as the first one is. Another is the obligation on HMRC, where there has been a faulty claim to enhanced protection under the lifetime allowance charge regulations, to notify the taxpayer of that. Who has the burden of proof for showing this warning has been given? HMRC, naturally, since only they have the information necessary to do so. If they cannot, a reasonable excuse may be established.

**Point 4: The postal rule**

If there is a dispute about whether something has been sent by the taxpayer to HMRC it will often be sufficient to prove
on the balance of probabilities that the item was posted by
the taxpayer, and not that it was received by HMRC.

The rule allowing service by post of tax documents is
contained in s115(2) TMA 1970, which provides that any notice
or other document to be given, sent, served or delivered under
the Taxes Acts may be served by post. That applies whether
the sender is HMRC or a taxpayer. It also follows from this
that the risk of non-receipt lies on HMRC since they are taken
to have accepted the risks inherent in the postal system by
THE VIEW FROM THE BENCH

by John Walters Q.C.

I am sometimes asked what effect my experience as a Tribunal judge has had on my practice as an adviser and advocate. There have certainly been cases where I have decided an appeal against the taxpayer when his advocate has advanced arguments which I know I would have thought persuasive when getting up a case as an advocate, but which have been shown to be wrong when HMRC’s case was professionally presented at Tribunal. In such cases I have been sympathetic to the losing advocate because I know that the case he had to meet had been inadequately presented in correspondence. The appellant in such cases – HMRC’s ‘customer’ – has had reason to be dissatisfied with the services supplied to him by HMRC.

Of course, as a judge, I am much more in tune with the prevailing currents of judicial thinking on topical matters. The Tribunal’s approach in avoidance cases is an obvious case in point, but I would also mention procedural matters. Case management issues are very largely left to the discretion of the judge handling an appeal at a particular time, and, for example, his/her decision on whether to hear a point as a preliminary issue can often be effectively unappealable, and will usually be taken against the background of the current Tribunal thinking on the desirability of preliminary issues being litigated as a matter of general principle. They are generally regarded as undesirable because they can easily lead to procedural inconvenience and delay later on, if the preliminary issue is appealed before the substance of the case has been heard and decided at first instance. Nevertheless I have learned to my cost – by not allowing a preliminary issue to be taken and hearing the whole appeal involving 8 distinct issues, any one of which would have justified a case on its own...
– that a preliminary issue can in the right circumstances be
the appropriate way to manage an appeal.

It is useful, also, to have some personal knowledge of the
other Tribunal judges and the issues or factors to which they
might be sensitive. We are lucky to have in our Tax Tribunals
a cadre of intelligent and experienced judges, and we are soon
to get a good many more, and it is expected that the issue of
follower and accelerated payment notices is going to lead to
a surge in the number of appeals.

Endnotes
1 See: Iliffe News and Media Limited and Others v. Revenue and Customs
Commissioners TC 02365 (1 November 2012)