CONSISTENTLY INCONSISTENT – APPEALS AGAINST FINDINGS OF FACT TO THE UPPER TRIBUNAL

By Michael Firth

As a rule, challenging a finding of fact made by the First-tier Tax Tribunal (FTT) on appeal to the Upper Tribunal is hard. It is supposed to be hard. Were it otherwise, every litigant would be tempted to seek a second bite of the cherry in the Upper Tribunal, meaning that (a) the Upper Tribunal would be overrun with challenges to findings of fact, and (b) rather less importance would attached to the first-tier stage.

Appeals against decisions of the FTT are only permitted on points of law (TCEA 2007, s.11). This contrasts with appeals in the civil courts, which are permitted to be made on the basis that the decision is "wrong" (CPR 52.21(3)). Nevertheless, the Courts have, for a long time, managed to fit some apparent errors of fact within the concept of an error of law, using a little ingenuity:

> "…it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene. It has no option but to assume that there has been some misconception of the law and that, this has been responsible for the determination." (*Edwards v. Bairstow* [1956] AC 14 at 36, Viscount Simonds).

The test that justifies this logic is demanding: it must be a case in which the true and only reasonable conclusion contradicts the determination. Examples of situations where it applies are (*Megtian Ltd v. HMRC* [2010] EWHC 18 (Ch), §11, Briggs J):

1. Findings based on no evidence at all;
2. Findings which, on the evidence, are not capable of being rationally or reasonably justified;
3. Findings that contradict all the evidence;
4. Inferences which are not capable of being reasonably drawn from the findings of primary fact.

Furthermore, the impugned finding of fact must be one that was significant in relation to the overall decision (*Reed Employment Plc v. HMRC* [2014] UKUT 160 (TCC), §176, Proudman J and Judge Herrington).

Would-be appellants who decide to challenge findings of fact are often reminded that the challenge must be specific and properly formulated:

> "What is not permitted, in my view, is a roving selection of evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong." (*Georgiou v. CEC* [1996] STC 463, 476, Evans LJ)

The above is clear in terms of the law on direct challenges to findings of fact made by the FTT. There is, however, an interesting and fundamental divergence in the Upper Tribunal authorities on the scope for indirect challenges to a finding of fact. In other words, if the appellant's argument is simply that the finding of fact is wrong, the Upper Tribunal will ask whether the only reasonable conclusion is that the finding was wrong. That is a direct challenge. An indirect challenge arises where the appellant argues that something has gone wrong on the way to the Tribunal reaching the finding of fact, and that something undermines the finding of fact even if it is not necessarily outside the range of reasonable findings of fact (for example, a failure to take into account a relevant consideration). That is an indirect challenge, and some authorities indicate that such challenges are not permitted.

This is of vital importance, because if indirect challenges to FTT findings of fact are not permitted (or only permitted on limited bases), it means that a Tribunal could follow an entirely defective process of reasoning in arriving at its decision of fact (for example, taking into account all manner of irrelevant considerations), but as long as the end result happens, by chance, to be within the range of reasonable conclusions, it is not open to challenge. In many cases, both the taxpayer's and HMRC's factual contentions are within the realms of reasonableness, which would mean that it actually would not matter whose case the Tribunal accepted or why, as far as an appeal was concerned. The Tribunal could flip a coin to decide the outcome.

In what follows, the authorities supporting the limited approach are considered, followed by the authorities supporting a broader array of indirect challenges to findings of fact. It is argued that the broader approach is plainly right.

The limited approach: direct challenges only

In *Charles v. HMRC* [2014] UKUT 328 (TCC), permission was given to the taxpayer to appeal an MTIC decision. Judge Berner, in giving permission, said that it was unclear on what basis the FTT had reached its decision on the factual question of whether the taxpayer's transactions were connected to fraud:

> "It is clear that HMRC's case in respect of connection was challenged, and in those circumstances we consider that it was incumbent on the F-tT to explain with greater particularity than it did why it preferred one explanation (that there was a chain including EMS) to another (that this was a failed deal). It did not mention, still less address, the fact that two references, EMS 0036 and EMS 39, appear to have been used on the same day. It is also unfortunate that the F-tT made no mention of the report of the Tech Freight visit since it is not apparent whether it considered that the contents of the report did not undermine the conclusion it had reached about

> connection from the remaining evidence or, instead, the F-tT simply overlooked it. It is, in addition, unclear whether any of the officers who gave evidence, whose names are listed without any elaboration, contributed to an understanding of the chain although it must be assumed that, as in other cases of this kind, HMRC officers can do little more, so far as identification of a chain is concerned, than produce documents they have obtained from the various traders." (§31 of the final UT decision).

The Upper Tribunal referred to the duty to give reasons, but only on the basis that insufficient reasons would be a ground for granting permission to appeal – not for allowing the appeal itself. In a situation of inadequate reasons, it saw its task as being to examine the evidence before the FTT to decide whether the FTT's factual conclusion was within the range of reasonable conclusions:

> "The fact that it is impossible to understand why the judge reached his conclusion may, of itself, amount to a ground for giving permission to appeal for the very reason that it is impossible to determine, until the appeal has run its course, whether there was sufficient evidence to support the tribunal's conclusions. The absence from the F-tT's decision in this case of clear reasoning has, therefore, made it necessary for us to examine the evidence ourselves in some detail in order to determine what conclusions the F-tT could reasonably have drawn from it." (§32).

The Upper Tribunal considered the evidence and concluded that there was evidence before the FTT from which it "could properly conclude" that connection to fraud had been established. This represents a very limited approach to challenging findings of fact: only direct challenges may be made. The duty to give reasons is viewed not as a means of testing whether the Tribunal has properly approached its decision-making task, but as assisting the Upper Tribunal to check that the factual conclusion was within the range of reasonable conclusions.

On that view, it would not matter whether the FTT had taken into account all relevant considerations or relied on irrelevant considerations in reaching its decision. Indeed, the Upper Tribunal may never know due to the absence of reasons. Even if irrelevant considerations were taken into account, the decision would stand as long as it was within the reasonable range.

A similar issue arose in *Annova Limited v. HMRC* [2014] UKUT 28 (TCC), but in respect of a properly reasoned FTT decision. The taxpayer on appeal sought to attack two pillars of the FTT decision that it ought to have known of the connection to fraud. One of those challenges was well-founded:

> "In these circumstances I consider that Annova's first complaint is wellfounded. In the absence of evidence that an investigation of manufacturers' accounts, trade magazines and websites available as at 11 April 2006 would in fact have revealed sales volumes of the relevant phone models, it was not open to the Tribunal to make the finding that it did."

It followed that the FTT's conclusion had been based, in part at least, on an irrelevant consideration/a consideration that should not be taken into account. The Upper Tribunal, however, asked itself whether, nevertheless, the FTT "would have been entitled" to reach the same conclusion:

> "For the reasons given above, I have concluded that Annova's first complaint is well-founded, but not its second. It follows that I must consider whether the Tribunal would have been entitled to conclude that Annova should have known that Deal 1 was connected with fraudulent evasion of VAT absent the impugned finding with regard to knowledge of sales volumes." (§33).

It was held that the FTT would have been so entitled. Once again, it can be seen that the only challenge permitted was a direct challenge. A decision that was reached by flawed reasoning was upheld because the end result of that flawed process was within the reasonable range.

A final example for present purposes is *Eyedial Ltd v. HMRC* [2013] UKUT 432 (TCC). That was also an appeal by a taxpayer against an adverse MTIC decision. At paragraph 84, the Upper Tribunal accepted that the FTT made an error in determining that the taxpayer had conceded the existence of fraudulent evasion of VAT and connection. The Upper Tribunal then went on to examine the evidence for itself in order to test whether there was "sufficient evidence on which the FTT could make such a finding" (§97).

Indirect challenges

Beyond these decisions, there are a large number of other decisions showing that a broad range of indirect challenges may be made to findings of fact on appeal, including:

(a) Inadequate reasons
(b) Failure to address a submission
(c) Taking into account irrelevant considerations/failing to take account of relevant considerations.
(d) Misunderstanding a party's case on the evidence
(e) Unbalanced assessment of the evidence/overplaying the evidence
(f) Failure to give proper weight to a relevant factor

(a) Inadequate reasons

With regard to the duty to give reasons, the authorities go further than saying that inadequate reasons is a reason to give permission to appeal. Inadequate reasons also amount, on their own, to an error of law:

> "The FTT's support for inferences and other findings by reference to unspecified further facts is not a proper

> exercise of the duty to give reasons and must be regarded as an error of law. A statement that the tribunal finds such facts as are necessary to support other findings or determinations is not itself a finding of fact at all and therefore contravenes the principles in Flannery." (*HMRC v. Pacific Computers Ltd* [2016] UKUT 350 (TCC), §44, Mann J and Judge Berner).

There is authority (indeed high authority) that in an appropriate case a lower Court/Tribunal's reasons need not be exhaustive and that appellate courts should not jump readily to the conclusion that the reasons are deficient. But equally, the authorities underscore the need for reasons as the gateway to checking the decision-making process:

> "And, while it is important that an appellate court should not be over-critical of any judgment, it is equally important to bear in mind that one of the main purposes of requiring a judge to give reasoned judgments is to ensure that the parties and an appellate court can see why he reached the conclusion which he did, and can assess whether he made any errors of law or fact." (*PMS International Group Plc v. Magmatic Limited* [2016] UKSC 12, §39, Lord Neuberger).

There is a spectrum as to what is required. Short practical questions call for short, practical answers (*Proctor & Gamble UK* v. HMRC [2009] STC 1990, §14 and §72 re: are Pringles similar to potato crisps?). Complex submissions may require a more reasoned rebuttal:

> "…we reach the conclusion that the Judge has not given adequate reasons for rejecting HMRC's submissions on this point. In particular, we conclude that: (1) the Judge's treatment of HMRC's alternative case was too brief; (2) the twenty points required much more by way of an intellectual exchange from the Judge than they received; (3) the twenty points did not receive a coherent reasoned

> rebuttal from the judge; (4) Mr Attenborough's evidence, even as explained by the F-tT, did not amount to a rebuttal, much less a reasoned rebuttal, of those points; (5) the Judge ought to have formed his own assessment of the alternative case and was not able to decline to do so on the basis that he did not have expert evidence to help him." (*HMRC v. CCA Distribution (in administration) Ltd* [2015] UKUT 513 (TCC), §118, Morgan J and Judge Herrington).

Reasons challenged should be raised clearly in the permission to appeal application to allow the Tribunal the opportunity to rectify any omission; however, the Upper Tribunal is alert to the risk of ex post facto rationalisation (*HMRC v. CCA Distribution (in administration) Ltd*, §108).

(b) Failure to address a submission

Related to the duty to give reasons is the duty to consider and properly address all substantial submissions made by the parties:

> "Where there is evidence, and it is evidence from which the tribunal is invited to make an inference, the tribunal must address that question and explain its reasons either for drawing an inference or refusing to do so. It is not sufficient simply to say that there was no evidence. The failure by the FTT properly to address the submissions of HMRC by reference to the available evidence was an error of law." (*HMRC v. Pacific Computers Ltd* [2016] UKUT 350 (TCC), §82, Mann J and Judge Berner).
>
> "In the circumstances the FTT failed to take into account a very important part of the appellant's case, and erred in law. Without seeking to decide the point, I can safely say that it was a point with significant merit." (*Projosujadi v. Director of Border Revenue* [2015] UKUT 297 (TCC), §31, Mann J).

(c) Taking into account irrelevant considerations/failing to take account of relevant considerations

Public authorities reaching decisions within their sphere of competence must take into account all relevant considerations and exclude all irrelevant considerations. The same applies to the FTT:

> "We therefore conclude that HMRC has established that the Judge took into account an irrelevant consideration. The question as to Mr Trees' knowledge was one of the central questions to be determined by the Judge. At [387], the F-tT stated that the case was a borderline case. In determining a central question in a borderline case, the Judge took into account, in favour of Mr Trees and CCA, an irrelevant matter…We consider that, on this ground alone, the Decision as to Mr Trees' knowledge cannot stand." (*HMRC v. CCA Distribution Ltd (in administration)* [2015] UKUT 513 (TCC), §§82…84, Morgan J and Judge Herrington).

> "Clearly, Vital Nut's prospects of establishing an Edwards v. Bairstow type of error of law were better if it was the Original Decision that was being appealed than if it was the Revised Decision that was the subject of the appeal. That is because, as we have noted, [55] of the Original Decision makes a statement about the evidence ("…there was no evidence before us …") that suggests that the FTT excluded from its consideration legally relevant and probative evidence that was undoubtedly before it. That, plainly, is very much Edwards v. Bairstow territory." (*Vital Nut Co Limited v. HMRC* [2017] UKUT 192 (TCC), §43, Marcus Smith J and Judge Bishopp – on the facts the FTT sought to correct the error through the review procedure).

It is for the appeal Tribunal to decide what considerations were relevant:

> "it is for the appellate tribunal to determine what considerations are relevant to the question at issue. It does not defer to the inferior tribunal in the selection or identification of these considerations." (*Teinaz v. Wandsworth LBC* [2002] EWCA Civ 1040, §36, Arden LJ)

Where the Tribunal has taken into account an irrelevant consideration or failed to consider a relevant consideration, the decision will not stand, unless the Upper Tribunal concludes that it would inevitably have been the same:

> "The words of paragraph [96] make clear that the considerations in [95] were material to the FTT's conclusion. Thus we conclude that the FTT took into consideration a materially irrelevant factor. Accordingly its decision betrayed an error of law…It does not seem to us that this was a harmless error involving no prejudice to Mr Wright or that the FTT would inevitably have reached the same conclusion had it not taken this factor into account. Accordingly we set the decision aside." (*Wright v. HMRC* [2013] UKUT 481 (TCC), §§47…48, Judges Hellier and Gort).

A conclusion that the decision would "most likely" have been the same is not sufficient (see, by analogy, *John Dee Ltd v. CEC* [1995] STC 941, at 953 per Neill LJ). This is fundamental to the adjudication process. If a Tribunal has wrongly excluded a relevant consideration, and its decision would not inevitably have been the same if it had not made that error, the formal decision reached by the Tribunal cannot be taken to represent that Tribunal's decision on the actual question posed to it by the case. On appeal, a direct challenge to the finding of fact will only succeed if it is outside the reasonable range. One could thus perfectly well imagine a situation where an FTT would have reached a different decision if it had taken into account the relevant consideration,

> but the actual decision is within the reasonable range. Without the irrelevant/relevant consideration test, a decision that does not represent the true decision of any Tribunal would be allowed to stand.

(d) Misunderstanding a party's case on the evidence

In order to reject a case on a factual issue, the FTT must first understand what that factual case was. If it turns out that the FTT has misunderstood a party's case on the evidence, that is an error of law:

> "…we have reached the view that the FTT failed properly to examine the evidence before it. That failure, in our judgment, can be attributed to a number of factors. First, the FTT had effectively closed its mind to a material part of the evidence put forward by HMRC which was unchallenged; secondly, the FTT misunderstood the case as put by HMRC, and accordingly asked itself the wrong question in relation to the evidence of orchestration and contrivance; and thirdly, in considering the evidence put forward by PCL, the FTT failed to test that evidence by reference to the surrounding circumstances, including in particular the orchestrated and contrived nature of the fraud with which 5 PCL's transactions were connected…the FTT erred in law in failing properly to address HMRC's case on the evidence, and in failing to give proper reasons for certain of its conclusions." (*HMRC v. Pacific Computers Ltd* [2016] UKUT 350 (TCC), §§75…85, Mann J and Judge Berner).

(e) Unbalanced assessment of the evidence/overplaying the evidence

It is often noted that the weighing of multiple factors when reaching an overall conclusion on a factual issue is pre-eminently a matter within the province of the FTT. Nevertheless, there appear to be limits to the deference that the Upper Tribunal will show to the FTT. The first is where the FTT's assessment of the evidence appears unbalanced:

> "There is force in the submission that the FTT overplayed the effect of the evidence. The statement that the consistent evidence of Mr Glyn and several of their friends was that his attendance at regular social Sunday dinners and other similar occasions "virtually ceased" does not stand well with his oral evidence that he saw "all of my friends whenever I could". Nor does it stand well with the significant number of other formal social occasions, often more than one each month, attended by Mr Glyn during 2005/2006. The evidence overall might justify the conclusion that there was, as the FTT found, a very significant loosening of his social ties, but the assessment of the evidence for the purpose of reaching this conclusion is not balanced." (*HMRC v. Glyn* [2015] UKUT 551 (TCC), §90, David Richards J).

In principle, such cases may be explained as instances where the Upper Tribunal infers that the FTT has not taken into account all relevant considerations.

(f) Failure to give proper weight to a relevant factor

Second, and related to the unbalanced assessment of the evidence, are cases where the FTT failed to give proper weight to a relevant factor. Traditional judicial review principles would indicate that such a complaint is well founded, if the decision-maker gave the factor a weight that no reasonable decision-maker could have given it. Upper Tribunal case law indicates a potentially broader and more intrusive approach:

> "The FTT did not subject the evidence of PCL's witnesses to scrutiny by reference to the factual evidence produced by HMRC and the inferences which HMRC submitted ought to be made from that evidence as a counterweight

> to the evidence of those witnesses. <u>The failure to give proper weight to the evidence of the officers</u> was, in our view, part and parcel of this overall failure in relation to the evidence." (*HMRC v. Pacific Computers Ltd* [2016] UKUT 350 (TCC), §75, Mann J and Judge Berner, underlining added).
>
> "The core of the FTT's decision is contained in paragraph's 127-174 of the Decision, under the heading "Our Decision – Applying the law to the facts". They consider a number of factors, many of which are plainly relevant and significant, in particular whether Mr Glyn had made a distinct break involving a substantial loosening of his family, social and business ties. But, as explained above, they also took into account irrelevant factors and they failed to have regard, <u>or sufficient regard</u>, to certain relevant factors. The FTT itself considered this to be a "borderline" case (see the Reasons for refusing permission to appeal at [10]). In such a case, the errors of law which I have identified mean that the Decision cannot stand." (*HMRC v. Glyn* [2015] UKUT 551 (TCC), §102, underlining added).

Conclusion

The statutory appeal mechanism places a lot of trust in the FTT by limiting appeals against their decisions to errors of law and, within that category, limiting direct challenges to findings of fact to cases where the finding is outside the reasonable range.

The appeal Courts/Tribunals themselves also place significant trust in the FTT by reading FTT decisions with the starting assumption that the Tribunal knew how to perform its role and what matters to take into account:

> "It is unrealistic for an appellate court to expect a trial judge in every case to refer to all the points which

> influenced his decision. As Lord Hoffmann said in *Piglowska v Piglowski* [1999] 1 WLR 1360, 1372, "reasons should be read on the assumption that, unless he has demonstrated the contrary, the judge knew how he should perform his functions and which matters he should take into account". He also rightly said that an "appellate court should resist the temptation to subvert the principle that they should not substitute their own discretion for that of the judge by a narrow textual analysis which enables them to claim that he misdirected himself"…" (*PMS International Group Plc v. Magmatic Limited* [2016] UKSC 12, §39, Lord Neuberger).

It is a crucial counterbalance to the above, however, that indirect challenges to findings of fact be permitted and taken seriously. Taking them seriously means that if it is apparent from the decision that in one or more ways the Tribunal has not performed its function correctly, the starting assumption must be disapplied and the decision must be set-aside unless the decision would inevitably have been the same. A successful indirect challenge thus reverses the burden of persuasion: rather than the appellant having to show that the finding of fact was outside the reasonable range, the question is now whether the only reasonable conclusion on the evidence was the one which the Tribunal reached. If it is not, the decision is unsafe and must be set aside.

'NO BENEFIT. NO TAX' – TRUE OR FALSE?

By Michael Flesch QC

Consider the following scenario: X, a UK resident, is a beneficiary under a discretionary trust created by his late father. The trustees are resident in Jersey. In June 2016 the trustees lend X five million euros (€5m) to help him to purchase a villa in Portugal for fifteen million euros (€15m). The loan is for a fixed five year term, secured on the property with the interest compounded/rolled up half yearly. The (compounded) interest is to be paid, together with repayment of principal, at the end of the fixed term. You may assume, that the terms of the loan and in particular the rate of interest, are such that it constitutes a fair bargain such as might reasonably have been entered into by persons acting at arm's length[1]. You may also assume that the trust is awash with ITA 2007, section 733 "relevant income".

I would have been prepared to advise, in June 2016, that on the basis of the above facts X did not receive a taxable "benefit" for the purposes of ITA 2007, section 731 *et seq* when the loan was made to him. At worst, any such benefit would have been relatively insignificant. And the position would have been the same for capital gains tax purposes: see TCGA 1992, section 97(4), as in force in June 2016.

The question that now arises is whether, and if so how, the above conclusion is affected by the enactment of Schedule 9 to the F(No 2)A 2017. In what follows I shall focus on the 'transfer of assets abroad' provisions in section 731 *et seq*. But the analysis should in principle be equally applicable for capital gains tax purposes.

Para 2 of Sch 9 inserted new provisions into the ITA 2007, as follows:

“742B Value of certain benefits

Sections 742C to 742E apply where it is necessary, for the purpose of calculating a charge to income tax under the preceding provisions of this Chapter, to determine the value of a benefit provided to a person by way of –

(a) a payment by way of loan (see section 742C)…

742C Value of benefit provided by a payment by way of loan

(1) The value of the benefit provided to a person (P) by a payment by way of a loan to P is, for each tax year the loan is outstanding, the amount (if any) by which

(a) the amount of interest that would have been payable in that year on the loan at the official rate, exceeds

(b) the amount of interest (if any) actually paid by P in that year on the loan.”

Since X will not actually be paying any interest on the loan until it matures in June 2021 it might appear that these new provisions impose a charge on him under section 731 *et seq.*[2] Given HMRC’s well-known distaste for ‘rolled up interest’ loans in this context, it is reasonable to assume that these new provisions were intended to apply to such loans. But do they apply to the loan made to X?

It is in my view clear, as a matter of construction, that sections 742B and 742C only apply where the loan in question actually constitutes a “benefit” to the borrower. If the loan does not confer a “benefit” on the borrower then the new provisions should not apply. There must be an actual “benefit” before one is required to value anything. That, on any fair reading, is what sections 742B and 742C say. Accordingly, if the terms of the loan made to X in 2016 were such that there was no “benefit” to him, he should not in my view be caught by the new provisions.

I am fortified in this view by the absence of a provision corresponding to the recently inserted section 173(1A)(a) of

ITEPA 2003[3]. Section 173(1A)(a) is intended to, and does, tax the so-called "benefit" of employer-related 'rolled up interest' loans which do not actually confer any benefit. The draftsman recognised the 'no benefit' problem and circumvented it by providing that where you have an employer-related loan "*the loan is a benefit for the purposes of this Chapter (and accordingly it is immaterial whether the terms of the loan constitute a fair bargain)…*" Job done! But, as I say, there is no corresponding provision in the context of the new sections 742B and 742C.

I recognise, of course, that HMRC might very well challenge the view expressed above as to how sections 742B and 742C apply (or don't apply) and I recognise further that, in the current climate, a Tribunal/Court might very well side with HMRC. Anyone contemplating making a new 'rolled up interest' loan today has been warned! But on my reading, sections 742B and 742C should not apply in the absence of an actual "benefit".

Even if I am wrong on the 'absence of benefit' point, X has a further argument as to why the new provisions do not apply to the loan made to him in June 2016. Para 3 of Schedule 9 to the F(No2) A) 2017 provides that: "*The amendments made by this Schedule*" – i.e. the insertion of sections 742B and 742C – "*have effect in relation to… benefits received in the tax year 2017-18 and subsequent tax years.*"

In my view any "benefit" received by X was received in June 2016 when the loan was made. Accordingly, the new provisions should not be in point.

Let us test it in this way. Suppose the five year term loan made to X in June 2016 was expressed to be interest free. Clearly X would have received a "benefit" when the loan was made, and the benefit would have been taxed under section 731 *et seq* in 2016-17. I hope that no one – not even HMRC – would seriously suggest that X received further taxable benefits in the five succeeding years, by virtue of sections 742B and 742C[4].

Now let us suppose that it transpires that the loan actually made to X in June 2016 contained a small element of benefit, because the agreed rate of rolled up interest was marginally too low to constitute a 'fair bargain'. Again, any such benefit should have been taxed in 2016/17 and should not be taxed again in subsequent years. That being so, it surely cannot be right in X's actual case – where his loan was a 'fair bargain' and did not confer any 'Day 1 benefit' – that he should be taxed by virtue of the new provisions. X's 'benefit' – or non-benefit – must equally have been received before 2017-18.

Again, I believe this argument to be correct. But, again, one should not be too surprised if, on some basis or another, it was successfully challenged by HMRC.

That leaves the question of what X should do. Realistically, he has only two options. First, X might take his chance that at least one of the arguments outlined above would be upheld, so that sections 742B and 742C do not apply to his loan. If this course is adopted it would be sensible for X to make full disclosure to HMRC. Alternatively, X could renegotiate the terms of his loan and pay interest each year at (at least) the official rate[5].

If this latter course is adopted one has to consider whether X is obliged to deduct, and account for, income tax at the basic rate when making the payment of interest: see ITA 2007, section 874(1)(d)[6]. This depends on whether or not the interest has a UK 'source'. The recent Upper Tribunal decision in *Ardmore Construction Ltd v HMRC* [2016] STC 1044, which purports to follow the House of Lords decision in *Westminster Bank v National Bank of Greece SA* [1971] AC 945, tells us that in determining source, one must apply "a multifactorial test"; this apparently requires a consideration of three factors, namely (i) the residence of the debtor; (ii) the location of the security; and (iii) the ultimate or substantive source of discharge of the debtor's obligation, i.e. where the funds used to pay interest and principal have come from.

In X's case, factor (i) suggests a UK source, factor (ii) suggests a non-UK (i.e. Portuguese) source and factor (iii) suggests a non-UK source (Portuguese or Jersey), on the basis that the payment of principal and interest will either be funded from a sale of the property or by a further loan from the trust. Precisely where this leaves us, when it comes to applying the multifactorial test, is anyone's guess. But Ardmore is due to be heard in the Court of Appeal in March this year so we should, or may, soon be a little wiser[7]. But don't hold your breath.

A tax adviser's lot is today not a happy one!

Endnotes

1. I recognise that HMRC might take issue on this point.
2. The House of Lords decision in *Paton (as Fenton's Trustee) v IRC* 21 TC 626 establishes that where interest is compounded/rolled up in a year it is not "actually paid" in that year.
3. Section 173(1A)(a) was inserted by section 7(8) of the FA 2016.
4. See *Billingham v Cooper* [2000] STC 122, at p.129h and p.134a.
5. By the time this article is read it may be too late to pay interest in 2017-18.
6. Typically, the loan agreement will provide that if the borrower is required by law to deduct income tax he must in effect 'make good' the deduction and pay the full gross amount to the lender.
7. This article was written in February 2018

THE CRIMINALISATION OF TAX LAW

By David Goldberg QC

It is, no doubt, possible to devise an enormous number of ways of raising taxes and many of those ways might seem unimaginable until they have been imagined.

For example, in the UK, some years ago now, we introduced two new taxes, one on insurance premiums and another on landfill, and their introduction was a complete surprise, something of a novelty to us though, I understand, that there were taxes of that kind in other countries.

Taxes of this rather narrow specific kind are, however, relatively unusual and, taking a broad theme, there are, in general, two different ways of raising tax which are relatively widespread: it is possible to tax by reference to turnover and it is possible to tax by reference to profits.

In devising a tax, then, a good starting point is to decide whether it is to be a tax on turnover or a tax on profits.

The next step to take is to decide from whom the tax is going to be collected and, here, practical considerations are going to play a large part.

It is obviously easiest for a political authority to tax those who live within its geographical boundaries and, after them, it is relatively easy to tax those people who do things within the boundaries of the authority even though they don't live there.

It is more difficult for an authority to tax a person who neither lives within the area over which it has power nor does anything in that region: it is, accordingly, inherently unlikely that, for example, a Chinese government will seek to tax Peruvians who live in Peru, never visit China and have nothing in the way of property or business in China.

However, what I have said so far leaves largely unaddressed what might be called the problem of the visitor: what is a tax system to do about a person who is very clearly based in Country X but does some things in Country Y?

Of course, to a certain extent, if the authority in question decides to tax only what happens within its boundary, the problem of the visitor does not arise in quite such an acute form: it doesn't matter where the person is, but only where he does things and what he does.

Even then, of course, an issue might arise: is the foreigner who is doing things in the territory doing as much as he could or should do in the territory, or has he artificially restricted what he does there?

Let me park that question for the time being and return to my initial theme of what the charge to tax is to be measured by: is it to be measured by reference to gross amounts (as turnover taxes are) or is it to be measured by profits?

In the early days I rather think that most taxes were local turnover taxes.

For example, about 3,500 years ago, in Egypt, the population had to pay 20% of their production of grain to Pharaoh.

If a farmer in Pharoah's realm grew 100 bushels of wheat he had to hand over 20 to Pharaoh.

The tax was relatively simple and, no doubt, if a person lied to the vizier as to how many bushels of wheat he had grown, that would have been a criminal offence with appropriate and unpleasant sanctions: it has always been illegal – a crime – to lie to a taxing authority; this talk is not about that kind of thing.

What this talk is about is the way in which political authorities are increasingly, and all over the world, imposing heavier and heavier sanctions for errors which may well be entirely innocent and certainly not deliberately dishonest.

My thesis is that the concepts underlying the way in which tax systems work are relatively uncertain and that that inherent uncertainty makes the sort of sanctions which are now being imposed wholly inappropriate.

A simple turnover tax, like the ancient Egyptian wheat tax, had the merit of being relatively easy to operate, but it also suffered the disadvantage that it might be difficult to pay.

If, to meet the costs of producing 100 bushels, it was necessary to use up **81** bushels of wheat, the farmer would only be left with 19 out of 100 bushels with which to pay the 20 bushels of tax.

That can, of course, be a problem with modern turnover taxes just as with ancient ones and it does not seem very attractive: a tax which means that you may end up poorer after a year's productive work is surely not a particularly good way of raising money.

I suppose that it might be regarded as a way of improving productivity and efficiency, but it is likely to be a very blunt way of achieving that and it could be a way of arousing resentment rather than efficiency.

One of the things that a political authority needs most from a tax system is that it has widespread public acceptance: if the tax system causes resentment, it is unlikely to work well and, eventually, it will have to be rewritten.

So one of the problems of a turnover tax is that it might arouse large scale hostility because it could be difficult to pay; and it surely seems much more sensible for taxpayers to be required to pay tax only when they actually have, or should have, the money to pay it.

It is, of course, possible to ameliorate the problems of a turnover tax by allowing for a system of offsets, rather in the way that a VAT or a GST does; but then the basic simplicity of the tax has been eroded and the offsets do not always make the tax easy to pay.

Because that is so, a tax on profits has, at least until recently, generally been seen as better than a tax on turnover and, at least until tax rates go above 100%, it is inherently likely that it will be easier for the taxpayer to pay a tax on profits than a tax on turnover.

But at this stage of the design process quite a big problem becomes apparent.

What, exactly, is a profit?

It turns out that it is very difficult to define profit, so difficult, indeed, that lawyers by and large left the field to accountants: if you want to know who made what profit, it is necessary to ask a businessman and the view of businessmen is generally taken to be represented by accountants.

But asking an accountant doesn't always produce the right answer: sometimes accountants increase profits by adding in things that lawyers don't think of as profits, and sometimes they don't take off things, or they add in things, that lawyers believe quite viscerally should be deducted or should not be added in, and there are, accordingly, cases where the accountants and the lawyers disagree and, in those cases, the lawyers usually win.

Disputes of this kind quite often relate to fundamental issues such as whether an item is income or capital: lawyers tend to get quite excited about questions of that kind, but they leave accountants and, very often, economists quite cold: they often regard the capital or income question as irrelevant.

The period to which a receipt or outgoing is to be allocated can also sometimes be a point over which lawyers and accountants disagree, and the issue of period illustrates one of the fundamental problems of computing a profit: the period over which accounts are drawn has a radical effect on the profit which is found to exist with, for example, the result that a single account drawn for a two year period does not necessarily produce the same result as is found by aggregating the results of annual accounts drawn for each of the two years separately; and this is an effect which is particularly acute where long term businesses are concerned.

So, although the basic principle is that the lawyers have left it up to the accountants to determine what the profits of a business are, the lawyers have not altogether left the field and, so far, I have not yet touched on what, in a sense, may be the biggest difference between the way in which lawyers and accountants thinks about profits.

By and large, accountants do not care about the form a profit takes: an accountant will say that an increase in value can produce a profit, but lawyers do not like that.

In terms of taxes on profits, lawyers say that there can only be a profit when the profit has been realised: the point has been very clearly illustrated here by the relatively recent **Nice Cheer** case.

The concern of the Courts in this context is that tax should only be payable when it is possible to pay it: if the tax system requires payment of tax regardless of whether payment is a practical possibility or not, it is likely to cause economic distortion: decisions will be taken, not in the interests of business, but in order to enable tax to be paid and that is a bad thing; if at all possible tax systems should be designed so that they do not distort decision making.

Anyway, no matter whether it is a good rule or a bad rule, the lawyers have, so far, won the day on the question of whether a profit must be realised or not: unless the relevant legislation says something different, the general rule is that, before a profit can be taxed, it must be realised.

I should perhaps make clear that legislation taxing unrealised profits is not altogether unheard of: taxes on capital gains, for example, often tax notional gains and there is, in some jurisdictions at least, an open question as to whether profits deemed to arise on the cessation of a business can be taxed before they have been realised but, nonetheless, the general rule is as I have stated it.

The underlying idea that tax should only be charged and be payable when there is money to pay it, was also reflected in other aspects of tax, not just those aspects where accountants and lawyers might clash.

For example, in relation to benefits given to employees there was and, to a certain extent, there is still, a rule that a benefit can only be taxed if it is in money or money's worth.

Now, it is, of course, a commonplace that the basis of all taxation is statute: there is nothing natural about tax at all; it is not like morality, it is not like the rule "thou shalt not murder", a rule which usually exists as a custom quite apart from a statute.

Rules of the thou shalt not murder kind are usually agreed upon by society without the need for a specific legislative rule; they are needed to make society work.

Now it might, no doubt, be possible to make a case that society can only work when tax is paid and it might or might not be possible to secure general agreement that tax is necessary.

But securing agreement on the nature and extent of a tax without there being in existence a legislative body capable of enacting a statute is likely to be impossible; and that is why it can be stated categorically that, if there is no statute, there cannot be a liability to tax.

There can, of course, even without a statute, be situations in which a practical obligation to pay money to another person arises: I have in mind the sort of case in which a local warlord demands a tribute from people who live in his territory and threatens to burn down their homes if they don't pay it, the sort of thing that happens in the film the Magnificent Seven.

I think we would say that cases like that involve extortion rather than taxation: the difference between the two forms of exaction depends on the existence of a statute

But it is also fair to say that the line between extortion and taxation can be quite a thin one: after all, might it not be said that the demand of a local warlord is a form of statute?

The reason that the warlord's demand is not a statute is, of course, that he usually does not have the political authority to make a statute, but that is the only reason that his rules are not statutes; he does, after all, have the practical authority to make rules.

Looking at the matter the other way round, it might be equally fair to say that a state's ability to exact tax can only be effective when there is a degree of extortion used by the state: for example, in a doubtful case, the tax man often collects tax by threatening adverse consequences to the citizen who does not pay up.

In other words, taxation always involves a mix of law and extortion, but we hope, on the whole, that the law prevails.

I think the narrative so far has revealed five points.

First, once a decision has been taken to tax profits rather than turnover, it becomes necessary to determine what is a profit.

Secondly, the determination of what is a profit requires the application of a mix of accounting and legal principles.

Thirdly, the perceived need to tax only when there is a practical possibility of paying the tax means that there is a boundary around the nature of a profit.

Fourthly, even a fairly elementary tax system, a system which just taxes profits, is, because of the first three points, quite elaborate.

And, fifthly, no matter how carefully a charge to tax is set down in words in a statute, the words will need some interpretation and probably expansion.

For example, all those rules I have outlined which define the meaning of the word profit are not to be found expressly set out in the statute: they come from judicial explanation of the meaning of the word "profits"; the mere use of the word profit brings with it, by implication, a host of limitations.

Now just pausing here, the way in which a tax system needs to be elaborated through decisions explaining the words used in the Taxing Act itself means that it is quite a delicate thing.

It may be, or appear to be, simple, but it is not dealing with basic rules like thou shalt not murder or thou shalt not steal.

And this means that tax law is an example of the sort of law which should undoubtedly be dealt with as a civil matter: it is too elaborate, too delicate to be dealt with as a criminal matter; it may be possible to misunderstand tax law and to get it wrong but to talk of a failure to get it right as a breach of the law is, in cases where there has been no dishonesty about the facts, a misuse of language.

Ahh! But those limitations on the meaning of "profits" are attractive to those who do not want to pay tax: if we do this instead of that, what happens may be a commercial profit but not a taxable profit because we have put ourselves beyond the boundary of what is taxable.

And the attraction encourages planners to look for ways of not paying tax: it is, after all, a given that nobody really wants to pay their own tax bill.

Of course, quite a lot of us think it is right that others pay tax but, if we are honest, the thought does not apply with quite the same rigour to our own position: if we can escape from tax without taking too much risk, we will all try to do that.

How is a political authority to respond to that?

Again, speaking broadly, there are four forms of response which could be adopted.

The first form of response is to do nothing: the situation can be accepted.

The ability to mitigate tax by moving value from one side of the profit boundary to the other seldom has adverse consequences on a budgetary scale; indeed, it may have beneficial consequences because a possible view is that economies work better when taxes are avoidable.

But, on the other hand, the ability to choose whether to pay tax or not can be seen as socially divisive and so unacceptable, adding to the gap between rich and poor.

The second response is to leave the tax system broadly as it is, but add a GAAR: that is, more or less, the response adopted in, for example, Australia, Hong Kong and, I believe, Germany.

The third response is to say that any attempt to mitigate tax is a crime.

But a little thought shows this is not going to work or, at least, ought not to work.

Most crimes involve doing things which the doer knows are wrong, wrong in a moral sense, wrong because they involve a lie, a deliberate failure to tell the truth.

Not paying tax because your profits have been lawfully calculated in a certain way is not at all the same thing.

Surely, that should not be criminal?

What wrong has been done by trying to use the law to pay less tax?

Could we even begin to give a name to that crime?

What name would we give it?

It is wrong to say that a tax scheme which doesn't work is a breach of the law: it is just something which doesn't work as it was hoped it would.

To call that a crime would be a very large step indeed.

The fourth response is to add more and more rules in an endeavour to be more and more prescriptive, and that is what has been done here in the United Kingdom.

But this kind of response brings with it a particular danger.

The addition of rules involves the use of words, many many words; and the more complicated the situation which the rule is supposed to cover, the more words are necessary to deal with it.

The words need to appear to lay down rules: if you do this there will be a tax.

But, in addition to laying down rules, the words are also creating more and more boundaries.

If there is a rule that says there will be tax on x, it immediately raises the question “Is there tax on y?” and, quite often, it will be found that the rule as expressed does not appear to impose tax on y.

Once upon a time – I do not speak of a time long long ago, but of a time well within my working lifetime – the Courts which are, after all, the decision makers in these situations would, at least in the UK and in Hong Kong, say “the literal words of the statute do not provide for there to be tax on y, therefore there is no tax on y”.

But about 40 years ago, adopting a fashion which had started in the USA in the 1930’s, UK and Hong Kong Courts started to interpret legislation purposively: they did not continue, as they once had, to ask and answer the question “what do the words used by the legislature mean when they are interpreted literally?” and they began to ask and answer the question “what did the legislature intend these words to mean?”.

Indeed, recent cases suggest that the Courts are no longer asking themselves what the legislature intended the words to mean but have gone even further and asked and answered the question “what would the legislature have intended the position to be if they had thought about this situation which they quite obviously have not?”.

There is scope for a good deal of argument as to whether the Courts have overstepped a theoretical dividing line between declaring the law on the one hand and making the law on the other.

But debate of this kind is arid and fruitless.

It is inevitable that, under more or less any system that can be devised, the declarer of the law will have to take creative decisions: in a sense, that is exactly what Courts were doing when they decided that profits meant realised profits; and it is worth noting that the decisions on that point were not, originally, decisions about tax but decisions about company law and whether companies could pay dividends or not.

The point is that law works in a fairly holistic way: those of us who practice in the field of tax can sometimes feel that we are victims of a changing climate, but we do need to recognise that, whatever we think or do not think about physical climate change, legal climate change affects the whole range of the law and not just tax.

A particular problem with tax, though, is that, in the UK at least, the statute has grown to an enormous length containing a host of rules designed to deal with different situations; and it changes at least once and sometimes two or even three times in a year.

As a result, the system has lost a single coherent theme: it is full of different rules for different situations and, to a very large extent, it taxes different types of person differently so that, for example, individuals are now taxed quite differently from companies.

Two other features have then been superimposed on this fractured structure.

First, there is an increasing belief, to a large extent adopted by the Courts, that tax is a natural thing which is, accordingly, to be everywhere and not just where the statute says it is.

The idea that there is a limit, or a boundary, beyond which tax is not to be found has, to a very large extent, disappeared from judicial thinking.

The second complicating feature is the wish of legislators to digitalise tax.

The idea is that we are just to report numbers on a computer – quarterly, perhaps, rather than just annually – and the computer will tell us how much tax to pay.

The problem with this idea is that it is based on the thought that working out a tax computation is as simple as adding 2 and 2 to make 4.

However, the real problem with a tax system is not the arithmetic, but discovering the numbers which have to be added together (or, in some cases, subtracted or divided).

The issue of what numbers are to appear in the computation requires, at the very least, an element of judgment and the judgment becomes more and more difficult as the legislation grows in length,

I think that the Hong Kong tax system has, to a large extent, so far avoided the dangers of prolixity and digitalisation, but the trend towards both those features is worldwide and cannot be avoided in Hong Kong, especially because the region thrives on trade which involves it in other tax systems.

Pausing in the analysis here, it can be seen that tax systems have fairly flexible foundations, which have had a complex framework erected on them while the administrators and, to a large extent, the courts, have endeavoured to maintain the position that tax is elementary in conception, straightforward to apply and (though the courts have not got involved in this aspect yet) simple enough that it can be digitalised.

Now that picture is, even viewed entirely domestically, a fake painting.

But it becomes even more apparent that it is a forgery when international elements come into play, so let me return to the question I parked earlier.

What happens when a business based in Country A does things in Country B?

How much tax is Country B going to charge the business?

The answer has, of course, primarily to be found in the domestic law of Country B.

But the amount of tax which Country B can charge will or, at least, may be affected by Double Tax Treaties.

And there may be a further complication because Country A may analyse situations differently from the way in which Country B sees them.

To take a well-known example, Country B may regard a business to be paying interest, for which a deduction is available in Country B, to Country A.

But Country A may disregard the receipt of the interest, with the result that there may be tax relief in Country B for the payment of the interest, without there being any corresponding tax charge in Country A.

And, on top of that, a business based in Country A may be able to arrange its affairs so that it is not doing business in (but only with) Country B; or it might be able to limit what it does in Country B just by doing some things at home; or it might be able to limit what it does in Country B by splitting its activities so that they take place partly in Country A, partly in Country B and partly in Country X.

None of this is particularly new.

We tend, of course, to think that, in the day of the internet, we are doing things faster better and more flexibly than we have done them before.

However, the internet works at the same speed as the telegraph; it may be more widely available than the telegraph was or, indeed, is, but it isn't faster.

It has, for generations, been possible to divide businesses between countries and to arrange matters so that transactions were "with" rather than "in" a territory.

Nonetheless, recent activities of global companies have caused considerable excitement not, I think, so much originally with administrators, but with politicians.

It has been discovered that, by using very traditional techniques, the Googles and Amazons of the world have been able to mitigate taxes in European countries – and, no doubt, elsewhere – without picking up (under its current legislation – Mr. Trump may be about to change this) tax charges in the USA.

And suddenly traditional tax planning has become unacceptable to many and a rather unattractive triumvirate has been let loose on the tax world.

First, there are the politicians who say: this company or that company is not paying very much tax and that must be the fault of the administrator.

It is, to the politicians, self-evident, that, if not very much tax is being collected from a multinational, the administrator has not been trying hard enough.

No thought has been given to the question of what the rules say: indeed, no thought has been given to whether there are or are not rules; the only thing that has been seized on is that what seems like not very much tax has been paid and that is, so it is said, unfair.

Secondly, the politicians have then encouraged their constituents to join in the belief that the tax system is working unfairly and against them; and the result has been a form of populism which demands an increasing tightening of the tax system: quite obviously, goes the populist mantra, anyone who is not paying the fair amount of tax must be made to pay it regardless of what the rules say.

There is no thought given to the possibility that a world without rules as to how much tax is to be paid would be infinitely worse than a world with rules, even if they are rules people don't like.

After all, without rules, we should be living in a world in which all tax – including the tax to be paid by those crying out for this system – would be obtained by extortion, not principle.

There does not appear, anywhere in the world, to be a politician who understands the need for rules let alone a politician who is willing to speak in favour of the rules themselves, rules which have a relatively proven track record and which allow tax to be computed fairly sensibly.

And thirdly, and on top of this ill thought out political maelstrom there has been added the OECD Action Plan to deal with Base Erosion and Profit Shifting ("BEPS").

These proposals, which have, in large measure, been adopted by the United Kingdom, are intended to stop multinational businesses from exploiting certain, but not all, of the benefits, available to them because of the fact that they are multinational.

The BEPS proposals seem to me to be largely irrational and unsoundly based, political rather than in accordance with the proper principles of taxation.

For example, one area in which they will operate is in relation to lending where it may, as I mentioned earlier, be possible under pre BEPS rules for a business operating in Country A and in Country B to obtain tax relief in Country B for certain payments (usually interest) which are not then taxed in Country A.

Under the new post BEPS rules, the business will not be allowed relief in Country B unless there is tax in Country A on the matching receipt.

But what is the rationale for this rule?

Before BEPS the tax systems of Country A and of Country B were each operating as they were intended to operate; Country A did not tax the relevant receipt, as it intended, and Country B gave relief for the relevant payment, just as it intended.

Why does Country B care about what is happening in Country A?

And, if it does care that there are differences between the way it imposes tax and the way Country A imposes tax, why is its concern limited to certain forms of difference but not others?

I do not have answers to these questions, but I shall make two over-arching comments about the BEPS proposals.

First, they appear to be a move towards a globally consistent method of taxation, a move which is out of accord with the general political mood represented by, for example, Mr. Trump and Brexit which indicate an increasing wish for individual countries to do things individually rather than globally.

It is odd that a populist inspired proposal should adopt what is undoubtedly an anti-populist global form.

Secondly, the BEPS proposals represent a move to a form of dishonesty in taxation, dishonesty not of taxpayers but of lawmakers.

Most taxes affected by the BEPS proposals are, supposedly, taxes on profits.

But rules like the BEPS anti hybrid rules which I have been describing, which deny deductions in certain cases for what are, undoubtedly, proper commercial expenses, move the tax system towards the taxation of turnover.

And BEPS is not the only move towards taxing turnover rather than profit: some countries are beginning to cap the deductions available for interest payments much more generally than BEPS does, again moving their systems away from the taxation of profits, and we here in the UK have imposed a diverted profits tax which is, yet again, a move away from taxing profits; indeed, it taxes non profits.

As I said at the beginning of this talk, taxes on turnover are, of course, a form of taxation which is well known but, if we are going to change our systems from the taxation of profits to the taxation of turnover, we need to say so openly: just as taxpayers need to be honest in their dealings with the taxation authorities, so do taxation authorities have to be open and transparent with their taxpayers; they must not be, as it seems to me they are, sly and stealthy.

The other aspect of BEPS is designed to ensure that multinational enterprises are booking an adequate amount of profit in each jurisdiction.

I believe that this is an aspect of BEPS which the Mainland finds particularly attractive and it means that all businesses operating in Hong Kong need to be particularly careful in structuring their dealings with affiliates on the Mainland.

But, it is again, a move towards turnover taxes and it is,again necessary to ask why changes are necessary?

What, after all, is wrong with the long standing method of determining where profits arise by a mix of, first, ascertaining exactly what earns a profit and where the work which earns it is done and, secondly, the application of well known transfer pricing rules?

The answer given by proponents of BEPS seems to be that the well known rules can be difficult to apply (in particular, the arm's length test can lead to much scope for argument) and quite often, so it is said, produce an unfair answer.

However, it seems to me that the traditional rules produce a coherent answer which accords with commercial reality.

BEPS, on the other hand, is likely to produce a wholly artificial result based on the belief that each country in a multinational chain must get a fair amount of tax.

For my own part, I have no doubt that the pre BEPS system of taxation is better organised and more principled than the post BEPS system.

Nonetheless, we are undoubtedly living in a world in which many people, including politicians, believe that there are problems with both domestic and international methods of taxation.

The perception that this is so is so pervasive and so strong that it has invaded, like a poisonous bacillus, the culture of multinationals themselves.

The result is that, instead of demanding the application of principled known and certain rules, many large business organisations, including especially banks, have (albeit with some brave exceptions), supinely accepted the proposition that there is a moral and social ethos which must be obeyed, requiring them to make sure that, regardless of what the rules say, they pay a fair amount of tax in every jurisdiction.

Indeed, in the UK we have some quite bizarre rules designed to enforce this over-riding ethos.

For example, banks are supposed to sign up to a code of conduct which precludes them from avoiding tax.

The code of conduct is in no way statutory but, if a bank does not sign up to it, there is a statutory rule that its name can be published as an organisation that has not signed up to the document it is not obliged to sign up to.

The combination of public perception and corporate acceptance has given administrators the opportunity to increase the complexity of the technical rules so that, in the UK, for example, we do not have only the thousands of pages of technical rules which I have mentioned but also a host of TAARS, one or two RAARS (which stands for regime anti avoidance rules), and, roaming above and around them all, a GAAR.

Moreover, a lot of this complexity has been encouraged and even asked for by special interest groups which have successfully lobbied for particular provisions which may be suitable and sensible for them but which are inconvenient for the general body of taxpayers.

The complexity is so great that it can take a very long time to determine that a computation is right.

And, enforcement of the complexity has been made easier for the revenue authorities by a radical change in the penalty rules, so that quite innocent errors can create liability for a significant, albeit civil, penalty.

The reality of the increasing complexity of tax systems is to be contrasted with the populist belief that tax is really really simple.

That belief is widely divergent from anything which can be called real, no matter how we define reality; but, nonetheless, a result of it is that, in the popular view, any business which has not paid the "fair" amount of tax must have cheated; and that will particularly be the case if, for example, the business structure involves the use of companies in tax havens like Panama or the Cayman Islands.

Now, of course, the use of tax haven companies is not a sign of criminality but the perception, that it is, is spreading and is compounded by some European jurisdictions which treat tax investigations as if they were criminal in nature and carry them out by means of armed raids.

It will, of course, be appreciated that in most, if not all, cases where a fair amount of tax has, in the public view, not been paid, what has happened will have been placed, in a full, open and transparent way, before the relevant authorities, so that there will have been no form of dishonesty whatever and the only issue will be how the law applies to what was done.

In other words nothing which could, on any sensible use of the word, be described as "criminal" will have happened.

But the widespread belief that not paying the fair amount of tax involves a criminal act has allowed taxing authorities to introduce new criminal sanctions for particular acts or failures by taxpayers, sanctions which are only socially acceptable because of the broad misconceptions about tax and the false belief that they will affect the few but not the many.

In the UK, towards the end of last year, we introduced criminal offences for the fraudulent evasion of income tax, for assisting in the evasion of tax, for failing to give notice of liability for tax and for failing to deliver a tax return.

The first of these was already an offence, and the second was probably an offence in any event, but the other two seem to be new: there is, however, a further offence of making an inaccurate return in relation to offshore assets and this offence seems particularly obnoxious.

The first four offences I have mentioned will usually involve something which can be seen as dishonesty: there will usually have been a deliberate lie or a wilful failure to do something which the defendant will know, or should know, that he should have done.

The fifth offence of making an inaccurate return can, however be triggered by an honest mistake; any mistake creates the offence, though the defendant has the opportunity to defend the prosecution by showing that he took reasonable care.

However, unlike the usual situation in criminal cases, the defendant must prove he is innocent.

There is also presently a proposal that those who "enable tax avoidance" may be liable to civil penalties for doing that if the schemes they enabled turn out not to work.

The proposal is of particular interest to advisers because they will be classed as enablers of tax avoidance schemes if they gave any advice intended to make the scheme work.

It is, of course, possible to take the view that none of this matters very much: after all, we all know that none of us are going to be criminal; it is highly unlikely that we shall ever face a charge under provisions like these.

But there is here a criminal offence of making an innocent error.

Is that right?

It marks a shift towards the proposition that it is criminal to make a computation of liability with which the relevant taxing authority does not agree.

Of course, the increasing trend towards the criminalisation of tax is a function of behavioural economics, though I believe it represents a serious misuse of these theories.

The idea is that the threat posed by criminal sanctions will push taxpayers to pay their taxes on time without doing anything in an endeavour to mitigate them.

But I rather suspect that the threats will be resented and that the criminalisation of tax will produce a tendency towards greater criminality rather than less: after all, if the sanction for error is severe, the wish to cover it up will inevitably be greater than it will be if there is no sanction.

Indeed, a better understanding of behavioural economics than that presently in use by revenue authorities would be to reward, and so to encourage, what is seen as good fiscal behaviour by a system of benefits for compliance.

Unfortunately authorities seem to be too narrowly focussed to see that.

A further problem is that the wish to see tax digitalised is likely to increase the pressure for errors to be automatically criminal, since computers are unlikely to be able to test motives and intention.

The push towards criminalisation seems to me to be indefensible when tax systems are so complex.

The dangers are increased by the possibility that a professional adviser can be sanctioned for doing his job and advising.

Again, is that right?

Is it principled?

Provisions of this kind limit – and are intended to limit – the ability to get advice in relation to tax; and they are accompanied by other provisions which are, in certain cases, designed to discourage appeals against revenue decisions.

I do not think that this increasing criminalisation of tax has yet spread to the expanding economies of Asia with whose businesses our businesses need to compete.

But it is part of a worldwide movement, encouraged by most politicians and by ill informed public opinion, which has departed from reality and believes that tax is so simple that any error, or indeed, any failure to pay the so called fair amount of tax must be the result of a crime.

The movement is populist: it is part of a growing tendency to make omissions rather than acts criminal, a tendency which can be seen, not only in tax, but also, in an equally unattractive way, in relation to corporate governance, a tendency which demonstrates how law is so often holistic; and it is dangerous.

Tax is not simple, but complicated: it requires the making of judgments by practitioners which can often be finely balanced.

The attack on the ability to obtain advice about tax avoidance is an attack on the rule of law itself.

The underlying foundation of the rule of law is the acceptance that there are rules which need to be enforced: tax is an example of the type of rule which must be enforced if the rule of law itself is to be upheld.

Of course, people who say that they do not have to pay tax may be unpopular in the way that people who say that others must pay tax can also be unpopular.

But our society needs to recognise that it is essential for both kinds of unpopularity to exist.

The current unpopularity of those not believed to be paying a fair amount of tax means that they are an easy target and there has, accordingly, been very little adverse comment about the way tax law has been and is being criminalised.

But there is a danger of contagion here: after all, if it is acceptable to limit the ability to get advice on tax, why is it not acceptable to limit the ability of guilty people to get advice about their criminal defence?

The democratic UK which, in large measure, gave the concept of the rule of law to the modern world, has, in its approach to tax avoidance, taken a dangerous step.

In the past, lawyers had to fight against monarchs and dictators for the right to defend their clients.

I have spent my career largely in the belief that I would not be tested in that way, that I should not have to risk my freedom to defend what I know to be right.

Yet, not so long ago, lawyers in the USA were fighting a government order, while the government believed that they should not have the right to do that.

Those lawyers are fighting for a cause which receives large scale acceptance among liberals and so, in that fight, the lawyers are seen as doing the brave and honourable thing.

The argument that tax law has to be defended – that the rules matter more than the sentiment, more than so called morality or social responsibility – appears unglamorous and does not get liberal support.

And yet; and yet.

It is actually far, far, more important that the unglamorous and unpopular fight for the sanctity of tax rules which have been democratically enacted is supported than that popular liberal causes are cheered: it is at the point at which the defence of the rule of law is receiving the least public support that it needs the strongest effort from those who understand the importance of rules.

Nobody in the public domain is clamouring for tax rules to be defended.

But if we do not defend them, what liberal bastion will fall next?

And do not say “oh – that is different; attacking tax avoiders is a good thing, let us applaud it”.

It is to the sound of applause like that that the rule of law dies and democracies become dictatorships.

The protection conferred by the requirement that rules must be enacted by Parliament is, God knows, little enough, but it is better than nothing: it is the only thing which divides a society governed by the rule of law from one which is governed by things.

Those of us who advise on tax, we stand on the weakest part of the wall which protects freedom: every day, a forrester in the dry thickets of the Taxes Act, I go proudly to work to defend it; I hope you will join me.

TAX PLANNING IN THE PRESENT CLIMATE
By Milton Grundy

We learned at mother's knee, that while tax evasion is bad, tax avoidance is OK. And now, suddenly, we find ourselves in a world where tax avoidance is no longer OK: the tax avoider is reviled in the press and frustrated in the courts, and now in the United Kingdom we are to have a measure which will penalise not only the avoider himself but those who helped him. Does this mean that we are no longer in a position to help a client pay no more tax than he has to, or is there a clear limit to the concept of 'avoidance', beyond which there are possibilities for legitimate tax planning?

The British statutes talk about "tax avoidance" and about obtaining a "tax advantage". I think they are the same concept in different words, and the essential feature of the concept is that it is *comparative*. Take that well-known passage from Lord Wilberforce's speech about *advantage* in *IRC v Parker* 43 TC 396 at 441, HL.

> "…there must be a contrast as regards the receipts between the actual case where these accrue in a non-taxable way with a possible accruer in a taxable way, and unless this contrast exists the existence of the advantage is not established…"

I do not read this as a statement of the law of England, but rather as an explanation of the meaning of the concept. If I am right about that (and I of course believe that I am), then what I write here about avoidance and obtaining a tax advantage is going to be either true or not true, whatever system of law we are talking about.

I said we "suddenly" find ourselves in a new world. But actually it has been coming for a long time – in the United Kingdom, at any rate. The first straw in the wind was the decision in *Black Nominees* [1975] STC 372. This involved a well-known film star called Julie Christie (although her name is mentioned only obliquely in the report of the case). She had put herself under contract with the trustees of a newly-created trust at a small salary. She then sold her interest in the trust to – as it happens – clients of mine, for a price which represented 82% of her earnings as an actress, and this was paid to her in instalments, as and when the earnings came in. It seemed to her like a great deal, because her earnings from acting were liable to income tax at 83%, whereas there was no tax on gains from sales of interests in trusts. The Inland Revenue were of course less pleased. And I believe that what really got up their nose was that the purchasing company did not pay tax on the fees either, because they treated what they paid Miss Christie as a trading expense! Everybody was very shocked when the court decided that what appeared to be instalments of the sale price of a trust interest were really her income as an actress and taxable accordingly. The *Black Nominees* case was decided in 1975, and I do not think anyone coming across the decision for the first time today would be in the least bit shocked. If I can write the script for my imaginary newcomer to the case, he might say – taking, he would say, a realistic approach to the situation, "Of course the money Julie Christie got came from acting in movies. Wherever else? And money film stars get from acting in movies is taxable income. I wonder why she bothered to appeal?"

The courts in the United Kingdom have had many opportunities of considering questions of this kind since the days of *Black Nominees.* A list of the leading cases is in Appendix I, and the upshot – and forgive me if I take here a very broad brush – is that this kind of 'realistic' approach has become part of our law, to the point that when the draftsman of Finance Act 2013 wanted a definition of arrangements which could be classed as "abusive" under the General Anti-abuse Rule, he would refer to those which sought to confer a *tax advantage*, and the concept was already a familiar one from the decided cases: if I engage in a transaction for the purpose of obtaining a tax advantage, the law will deny me the advantage. The concept is not unique to the United Kingdom: it is expressly embodied in many of our colonial statutes; I have had American lawyers explain to me the decision in *Aikens Industries* [1971] 56 TC 925, and it seems the Americans have had a similar doctrine for years; it is not essentially different from the concept of *abus de droit* in civil law countries; and it informs much of the thinking behind the OECD initiatives.

How does this affect the advice we can give our clients? I think we can take the expression "tax advantage" as the frontier between what we can advise and what we cannot. On this side of the frontier is legitimate tax planning. On the other side is the scheme which is not going to work, and which – in the United Kingdom – can penalise me for helping the client to do it. I should say straight away that not every series of events which results in the Treasury collecting less tax, means that somebody has been engaging in tax avoidance. It's a mistake a lot of people make – journalists especially. Take the case of Sir Philip Green. He gave his wife some shares in a UK company, so that after the gift she enjoyed the dividends declared by the company – which sounds altogether harmless, until you know that while Sir Philip resided in England, his wife lived in Monte-Carlo, with the result that the effect of the gift was that no UK tax was paid on the dividends. The Press were up in arms. 'Wicked tax avoider;' they cried. There were other aspects of Sir Philip's behaviour which were criticised, but they are not to my purpose here. The question I want to ask is, 'Did he avoid any tax?'

As I say, *Avoidance* and *Advantage* are comparative concepts. An "advantage" cannot exist on its own: there has to be something less advantageous you can compare it with. So also with "avoidance". Consider the sentence, "You can take the autoroute* to Nice airport and avoid the Promenade des Anglais." That tells us that there *is* another route, which goes along the Promenade des Anglais. It may be the shorter route. And were it not for the heavy traffic at the height of the season, you might well take it. But you can go a longer way round and so avoid the traffic. To put it in general terms: if there is a Route A which avoids, there has to be a Route B which may be the shorter route to the same destination but does not avoid. If you took the wrong turning on the autoroute and went instead to Ventimiglia, you would not say, "I found a way to get to Ventimiglia, avoiding the Promenade des Anglais", because there is no route from here to Ventimiglia which includes the Promenade des Anglais. The same is true of avoiding tax. If I engage in a transaction by which I avoid tax, that is my Route A, and it posits the existence of a Route B, which may be the obvious way to go but would involve a higher tax liability. Let us go back to the case of Sir Philip Green. He gave shares to his wife and paid no tax on the dividends. That was his Route A. If the transaction were to constitute tax avoidance, there would have to be a Route B, which would lead him to the same destination, but involve a tax liability. It seems to me that Sir Philip had no Route B. There is no way under our law for a man to make an outright gift of shares to his wife and remain liable for tax on future dividends. You might say that Sir Philip's gift to his wife was not like going to Nice airport, where you have the choice of going along the Promenade des Anglais or not. It was more like going to Ventimiglia, where there is no Promenade des Anglais to avoid. And I am comforted in the correctness of my view, by the fact that Her Majesty's Revenue and Customs evidently are of the same opinion, for no proceedings appear to have been taken against Sir Philip in respect of this transaction.

I should now like to look at a few transactions which have benign tax consequences, and try to see whether they are Nice Airport transactions, avoiding the Promenade des Anglais, or Ventimiglia transactions, with no Promenade des Anglais to avoid. Let me start with the dilemma faced by a UK resident individual who has an asset which has appreciated in value and plans to go and live in the United States. He does not want to sell the asset before he leaves, because that way he will pay UK tax on the gain, which does not seem fair, because he will be contributing to the cost of UK government services he is not going to be in the United Kingdom to enjoy. But if on the other hand he sells the asset when he is a resident of the United States, he will have to pay US tax on the gain, which does not seem very right to him either, since the gain will have accrued before he becomes resident in the United States. What he does was this. While he is still UK resident, he transfers the asset to a partnership in which he and his wife are partners. That occasions no charge to tax. Once he has become US – resident, the partnership sells the asset. That gives rise to no gain, because the Americans treat the base cost to the partnership as the market value of the asset when the partnership acquires it from the partner. Does he avoid tax? Of course, neither the US Treasury nor the UK Treasury collect any tax, but that, as I have said, is not the answer to the question: we have to look at what he has done and whether he could have done it in a way which would have cost him more tax. What he did in the United Kingdom was to transfer his asset to a partnership and then become non-resident. This was his Route A, and there was no tax cost. But there was no Route B: there was no way he could have incurred a tax charge by giving his wife a share in the asset. So – no avoidance. Similarly, from a US perspective, there is no way the partnership could have disposed of the asset and triggered a tax liability. This example may, I think, serve as a model of the kind of planning that is still open to us.

Let me turn now to a case which has an offshore element. This always tends to make people assume that some kind of avoidance is going on. But let us see. I have of course changed the names to protect the innocent, but otherwise the facts are these. Mr X is a UK resident and has three cousins resident in other places. His cousins are planning to create a fund for the benefit of the family as a whole. A Cayman bank owns all the units in an offshore accumulating discretionary unit trust. The proposal is that the four cousins buy all the units from the bank, keeping some units for themselves and giving others to younger members of the family. Non-UK readers should know that if Mr X transfers assets to an offshore entity and has what the statute calls "power to enjoy" the income of those assets, the statutory provisions have the effect of attributing the income of the offshore entity to him. But in this case he transfers nothing to the unit trust. He purchases the units from the bank and pays the price to the bank. This does not bring him within the statutory wording: these require the taxpayer to have "power to enjoy" the income from the assets he transfers or assets derived from them, and Mr X does not in any sense have power to enjoy any income arising from the assets transferred. What he has power to enjoy is the income of the assets which the trustee of the unit trust owned before he came on the scene. In the past, my view would have been that Mr X does not come within these provisions at all. But now? Now I think we have to ask ourselves whether Mr X could have achieved his objective in a more tax-prone way. By purchasing the units, he gets to share in a fund which can accumulate income tax-free and to which family members can call upon for help if needed, but the units have no value to a creditor or a disaffected spouse or indeed anyone outside the family, which may result in some wealth tax or estate saving. There may well be a way of achieving the same – or at any rate a very similar – result in a more tax-prone way, but if the facts are this this is the only offer on the table, Mr X can truly say that he has no Route B.

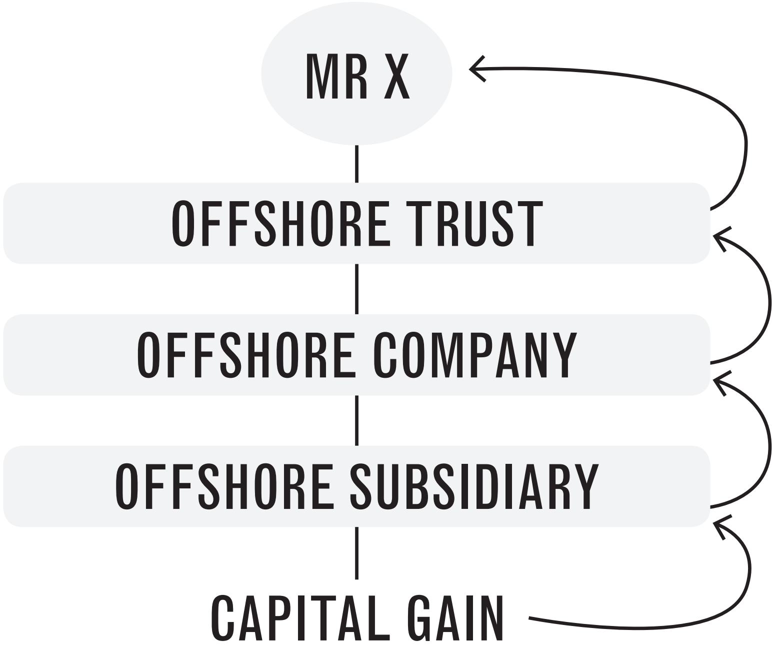
The question we need to ask ourselves each time is, "Is there a Route B with a tax charge along the way?" Sometimes there is no Route B because the tax authorities, by legislation or practice, do not provide one. Suppose I, as a UK resident, buy an offshore "bond", which is essentially a wrapper for a portfolio of investments, plus a tiny amount of life assurance. I draw down 5% of the premium each year, and pay no tax until the policy matures, in 20 years' time. Even assuming we have income tax in 20 years' time, it is still quite a *coup* to postpone payment of tax for, on average, 10 years! But there is no Route B, with a tax charge, because the legislation expressly provides that there should not be. Sometimes there is no Route B, because the tax has never been enacted. There is, for example, no tax on unrealised capital gains. So I do not have to look for a Route B if I buy leases at peppercorn rents, or shares that declare no dividend, and wait for them to increase in value. The legislation does not require me to pay tax while I wait. This is a proposition which people find easy to accept when the assets in question are blocks of flats in Mayfair, but more difficult to accept where the investments purchased are units in a unit trust in the Cayman Islands. But the location of the assets is immaterial: I cannot obtain a tax advantage by buying assets which yield no income, wherever they are located. Of course, I may run up against anti-avoidance provisions which attribute to me income which is not really mine; but in that case I pay tax because the legislation says so, not because of any general anti-avoidance rule. Just as there is no Route B for the investor in non-income-producing assets, so there is similarly no Route B for the non-UK domiciled individual who goes to live in the United Kingdom or for the non-Italian who goes to live in Italy, or for the non-UK resident who stays in the United Kingdom for no more than 89 days each year.

There are some transactions which strike one as a bit too good to be true, which suggests that they may be struck down as avoidance. I recall the case of the US citizen living in London, who wanted to make charitable donations. He was of course liable for both UK and US tax. If he gave to a UK charity he got no US tax relief, and if he gave to an American charity, he got no UK tax relief. His solution was to establish a US charity with a UK charitable company as a subsidiary and give to the UK company. That satisfied the requirements for tax relief in both countries. And if we are going to apply the "Is there a Route B with a tax charge?" test, we can start by applying it to the UK tax result. And the answer is that he made a gift to a UK charity, and obtained UK tax relief for doing so, and there just is not a way he could have made that gift and not obtained a UK tax benefit by doing so. I understand that the US charity would make an election under s.7701 of the Internal Revenue Code, with similar consequences in the United States. I believe that the transaction was in fact blessed by HMRC and the IRS, which is a comforting piece of information.

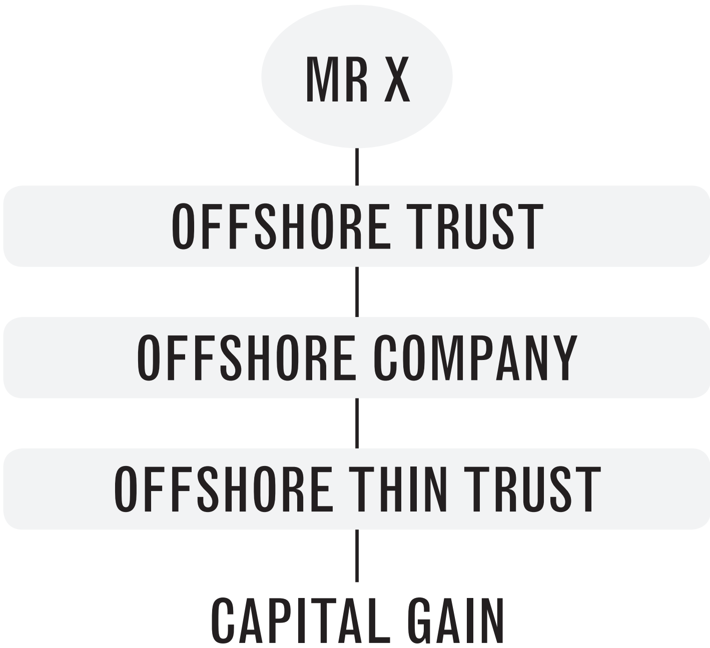
It is sometimes said that conduct is avoidance if it reduces your liability to tax in a way that conflicts with the policy objectives of the relevant legislation, and that is why giving up smoking is not tax avoidance. Well, you can argue about the policy objectives of tobacco duty. How much is it about reducing smoking and how much about raising revenue? But – to pursue my analysis – the reason giving up smoking is not avoidance is because there is no Route B: there is only one route to becoming a non-smoker, and that involves saving on tobacco duty; there is not another route whereby you can become a non-smoker and still pay tobacco duty!

But there are cases where policy objectives seem more relevant. The United Kingdom, like many other countries, taxes lifetime gifts. But it offers an exception for taxpayers who make gifts and survive seven years. A typical problem here is the father who would like to give assets to his son, but fears they will be dissipated in Ferraris and blondes before the son reaches an age of discretion. Up to a decade or so ago, father would often solve this problem by settling the assets for the benefit of the son, but the tax costs of the settlement route now makes this unattractive. Life insurance offers a solution: father's gift is an insurance policy which gives the policyholder limited access to funds for an initial period. This seems an ingenious solution to the problem created by the effective demise of the family settlement, but actually, it is plain vanilla inheritance tax planning, and there is no Route B, where the parties could achieve the same result and incur a tax charge. The discounted gift policy is a variant of this. Father takes out a policy which confers on the policy holder two rights – the right to a sum on maturity and the right to draw down 5% of the premium each year for 20 years or until he dies. He gives the first right to his son, and he retains the second. The gift is taxable, if father fails to survive seven years, but the value of the gift may be much lower than what the donee ultimately receives. Here again, there does not appear to be any more taxable way of achieving the same result.

If I am going to be guilty of avoidance, do I have to do something myself, or is it sufficient that trustees of a settlement of which I am a beneficiary, or directors of a company in which I am a shareholder, take some steps to shield me from a tax liability? We generally think of an avoidance transaction as one in which the taxpayer participates – he borrows some money, say, or joins a partnership, and then receives a benefit which he hopes will not be taxable. But that is not necessarily the pattern. Let me take an example. Readers from outside the United Kingdom should know that we have a provision which attributes the capital gains of non-resident companies to resident shareholders, or to resident beneficiaries of settlements whose trustees are shareholders. This cannot be circumvented by the company having a subsidiary, because the capital gains of the subsidiary are attributed to the parent, and so on, like this: –



Here at the top is Mr X, a UK beneficiary of an offshore trust. The Offshore Trust owns an Offshore Company, which has an Offshore Subsidiary. The Subsidiary makes a capital gain. That gain is attributed to the Offshore Company, and in turn to the Offshore Trust, and in turn to Mr X. Suppose, now, the offshore company substitutes for its subsidiary a Thin Trust, thus–



"Thin Trust" is my shorthand for a trust which has effectively only one beneficiary but is not a nomineeship. In this structure, the gain is made by the Thin Trust, of which the Offshore Company is the beneficiary, and while there is machinery for attributing gains of companies to trusts, there is no machinery for attributing the gains of trusts to companies. So, since the gains of this Thin Trust cannot be attributed to the Offshore Company, there is nothing to attribute to the Offshore Trust, and in turn nothing to attribute to the Resident Beneficiary. Is the concept of avoidance broad enough to cut through the Thin Trust and visit the capital gains tax liability upon the Beneficiary? The offshore company, it may be said, took the route of establishing the Thin Trust, to make the investment which yielded the gain (Route A), when it had the perfectly good alternative of making the investment itself (Route B), and did so in order to obtain a tax advantage for the Resident Beneficiary.

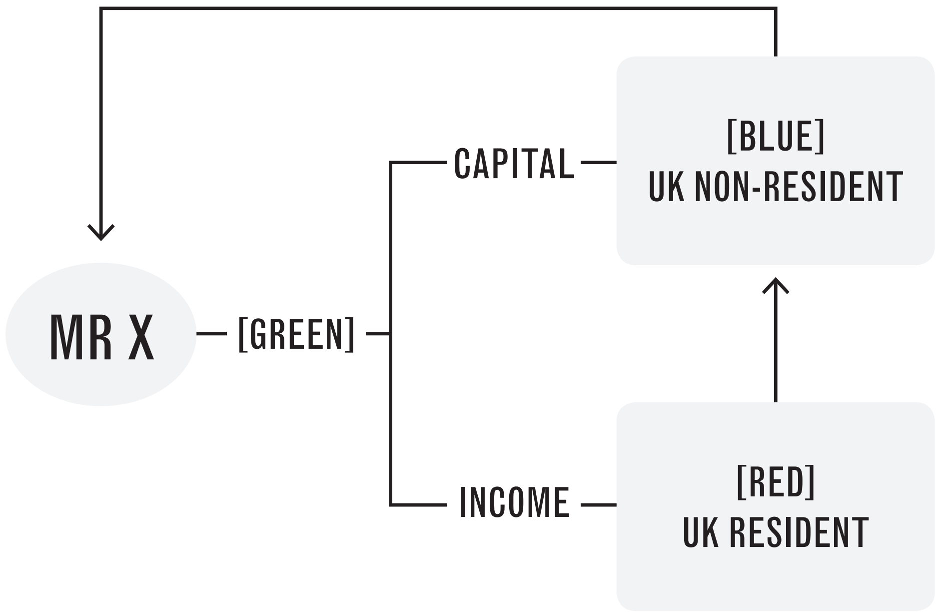
Is that avoidance? That is a difficult question, and I have not been able to find anything in the UK cases which throws any light on it. If I had to form a view, I should say that it depends on the part the Beneficiary played in the transaction: if the trustees acted at his behest, I should say he avoided, and if not, not. I am strengthened in this view by the wording of our General Anti-Abuse Rule. The Act talks about the taxpayer who *obtains* a tax advantage. That indicates some *act* on the part of the taxpayer. You cannot *obtain* anything unless you do something to get it. So, if I am the beneficiary of an offshore trust, and the trustees – quite without my knowledge – do something which gives me a tax advantage, I do not think I "obtain" that advantage.

Does the doctrine of avoidance extend to denying the benefit of a tax treaty in a case where a structure has been created for the purpose of obtaining the benefit of the treaty? Let us look at a couple of cases where this question arises. Suppose trustees in Bermuda hold a copyright which is going to generate royalties in the United Kingdom. They know that they will suffer UK withholding tax on the royalties. They also know that a resident of Barbados would receive those royalties without any withholding tax, under the treaty between Barbados and the United Kingdom. So they establish a sub-trust in Barbados, and transfer the copyright to the subtrust – which then holds the copyright and receives the royalties. That may not at first seem like a great tax planning manoeuvre: true, the royalties may be exempt from UK tax, but the trustee in Barbados is subject to local tax on the royalties at 40%. What I have not told you is that in Barbados distributions to beneficiaries are treated as deductions in computing the income of the trustees. So they established a second subtrust in Barbados, which was an Exempt Trust and received distributions from the taxpaying trust. The taxpaying trust then had only a tiny taxable income, and the distributions were exempt in the hands of the Exempt Trust. The whole arrangement has a kind of "too good to be true" feel about it, but it seems to me that each of the parties is paying the right tax on the income it has and none of them is avoiding any tax.

Similar considerations arise with the kind of structure I have in the past called the "Double British". This is a structure designed to take advantage of the tax treaties to which the United Kingdom is a party, in order to reduce the withholding tax levied by other countries on dividends arising in those countries. Most countries levy withholding tax on outgoing dividends, but tax treaties generally provide that tax is either not charged or is charged at a reduced rate on payments to a UK company. A UK company, however, pays no tax on incoming dividends and charges no tax on outgoing dividends. It follows that the investor living in – say – Monaco can receive dividends from a UK investment company which represent non-UK dividends taxed only at the tax treaty rate. The fly in the ointment is that UK companies pay tax in their capital gains.

So what the "Double British" structure does is use two UK companies – one beneficially entitled to the dividends and the other holding the capital as co-trustee of a trust of which the non-resident is the settlor.

The structure looks like this:

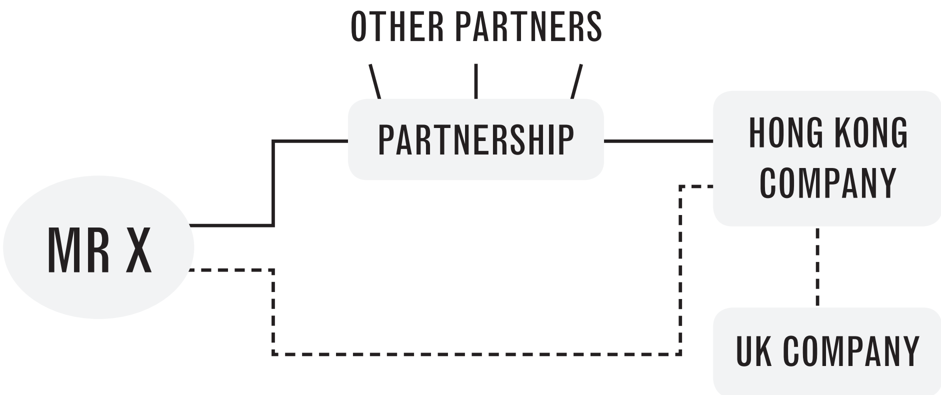


The circle on the left of the diagram is our Mr X – this time an individual resident in Monaco. He owns an offshore company, represented here by the rectangle marked BLUE, which in turn owns a UK resident company – the rectangle marked RED. Mr X has made a "Thin Trust" – which I show marked GREEN, settling the sum to be invested on the Blue Company and the Red Company as trustees, on trust to pay the income to the Red Company for its own benefit and subject thereto for the Blue Company. The two companies agree that trust investments will be made by the Red Company as joint trustee. Dividends flowing from UK companies and companies in treaty countries are beneficially owned by the Red Company and not subject to tax in the United Kingdom. But the Red Company is a "resident of the United Kingdom" for treaty purpose and is entitled to receive dividends from treaty countries with no withholding tax or a lower rate of withholding tax, as prescribed by the relevant treaties. The Red Company makes an onward declaration of dividend to the Blue Company – there being no tax liability on the way. When a capital gain is realised, this accrues to the Red Company as joint trustee, which can, it seems to me, if necessary take advantage of the capital gains article in the relevant treaty. The Red Company is acting in two capacities. It receives as beneficial owner the dividends arising from the trust investments, and enjoys the UK's benign corporation tax regime for companies receiving and paying dividends. It receives the capital gains from the sale of trust investments as trustee of a settlement made by a non-resident settlor and enjoys the UK's equally benign capital gains tax regime for gains arising from the sale of the trust investments. And the Red Company has in my view treaty protection in both capacities. It declares dividends (representing the trust income) to the Blue Company, which declares dividends (representing the capital gains and the dividends from the Red Company) in favour of Mr X.

Is this structure vulnerable to attack as "avoidance"? Suppose the Red Company is entitled to a dividend from a US corporation. Can the IRS argue that the Red Company is not entitled to the lower rate of withholding tax provided by the UK/US Tax Treaty, because the individual in Monaco always had a possible Route B: he could perfectly well have made the investment in the US corporation in his own name, and only used the UK company to obtain a treaty advantage? The argument is tempting, but I think wrong. This alternative is not a route to the same destination – there is all the difference in the world between running a business oneself – even an investment business, and being a shareholder in a company running a business. Once again it seems to me that each of the parties is paying the tax it should, and one cannot actually point to an avoider.

I am thinking of this structure primarily in terms of portfolio investment. But it is applicable to direct investment, and one additional advantage the use of the UK company provides is the benefit of the Investment Protection Treaties to which the United Kingdom is party. They are not very well known to tax specialists, but they can be very valuable where investment is made in a politically unstable place, and can offer a very good non-tax reason for taking a Route A as opposed to a Route B.

In the next case, the taxpayer is planning to start a new business which he expects to sell after a few years at a substantial gain. He can see a way for the business to have a high base cost, so that he would have no capital gains tax to pay when he sold out. He had a long history of doing business with a company in Hong Kong, and they were both partners in a partnership which carried on a separate business in Hong Kong.

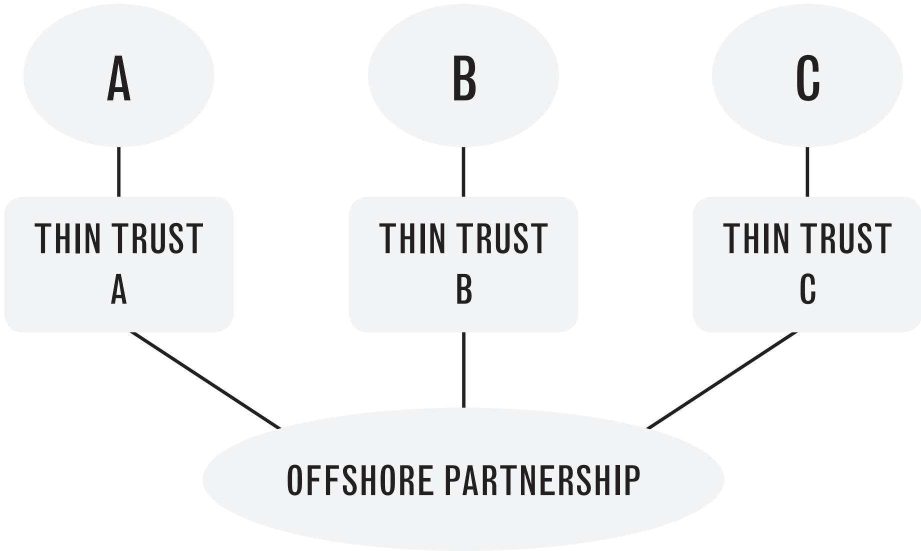


Mr X is a UK resident. He is in partnership with (among others) the Hong Kong Company. The Hong Kong Company forms a UK company and makes a contract with Mr X, shown as a dotted line, under which Mr X can buy the UK company in ten years' time, subject to some condition – perhaps that Mr X has not in the meanwhile resigned from the partnership. The price

Mr X agrees to pay will of course allow the Hong Kong Company to make a profit, but – all being well – the price will be a mere fraction of the value of the company at that time. Nevertheless, the acquisition cost of the shares to Mr X, for capital gains tax purposes, will be their market value at that time, which means that the growth in value of the shares over the ten year period will effectively escape tax. The key to this effect is that Mr X and the Hong Kong Company are "connected persons", and they are connected because they are in partnership together – even though the partnership business has nothing to do with the share purchase. In Appendix II is a note of the relevant UK statutory provisions. But I believe many jurisdictions treat transactions between connected persons as taking place on arm's length terms, whatever may be the actual terms agreed between the parties. In most cases, the effect of this is to increase the amount of tax payable. But here it has the opposite effect: Mr X has a base cost for his shares in the UK company equal to market value, even though he has acquired them for a trifling sum.

Does this still work? A few years ago, I would have given it a clean bill of health – from a UK point of view – without a second thought. Now, one needs to look at it more carefully. Could not Mr X simply take the route along the Promenade des Anglais, instead of going via the motorway? Is there any point in involving the Hong Kong Company at all? I think this last question gives us the clue to the answer. If there is some commercial reason for involving the Hong Kong Company – if the Hong Kong Company provides finance or marketing or has some other non-tax function, then I think the structure still works.

For my last example, let me say farewell to the ever-obliging Mr X and look at Mr A, Mr B and Mr C. The three of them plan to form a partnership to do business offshore. They want the partnership to be resident offshore, and to that end, they do not become partners themselves, but have their Thin Trusts as partners – so.



A, B and C are individuals resident onshore, but the trustees of Thin Trust A, Thin Trust B and Thin Trust C are all offshore. The partnership is one where the division of the profits is not known, but is left to be determined by some committee or a formula, so that the income of each partner is not known until later – perhaps not until the time is well gone by for taxing it. This looks like the kind of blatant tax avoidance which is the natural victim for anti-avoidance measures, and perhaps it is, though it is not easy to put one's finger on any party who has anything to be taxed: A, B and C have no income, and the UK system does not tax partnership income as such. All the same, I should be inclined to tell the clients to find some commercial reason for this arrangement. Perhaps Mr C lives in some country where he is afraid of expropriation and will only join a partnership if it is constructed on this basis.

TINA – There Is No Alternative. The phrase was put into the language by our former Prime Minister, Margaret Thatcher, and died with her. Perhaps it is time for it to come back – in the form, maybe of There Is No *Taxable* Alternative – TINTA. How is it these dividends paid to my wife in Monaco attract no tax? Why are these offshore partnership profits not taxed?

What is the secret of Tax Planning in the Present Climate?
I offer a one-word answer –
TINTA: where There is No Taxable Alternative.

** This article is adapted from a talk given at an ITPA meeting in Monte-Carlo.*

Appendix I

UK Decisions 1975 – 1997

Black Nominees v Nicols [1975] STC 372
Floor v. Davies [1978] STC 436
IRC v. Plummer [1979] STC 793
IRC v. Burmah Oil [1982] STC 30
Furniss v. Dawson [1984] STC 153
IRC v. Challenge Corporation [1987] AC 155
Craven v. White [1988] STC 476
Ensign Tankers v. Stokes [1992] STC 226
IRC v. McGuckian [1997] STC 908

Appendix II

His acquisition occurs when contract becomes unconditional.

Taxation of Chargeable Gains Act 1992 ("TCGA") s.28(2).

> If the contract is conditional (and in particular if it is conditional on the exercise of an option) the time at which the disposal and acquisition is made is the time when the condition is satisfied.

Mr X "connected" with Hong Kong Co.

TCGA s.286(4).

> Except in relation to acquisitions or disposals of partnership assets pursuant to bona fide commercial arrangements, a person is connected with any person with whom he is in partnership…

Mr X's acquisition cost of shares is market value.

TCGA s.17(1).

> Subject to the provisions of this Act, a person's acquisition or disposal of an asset shall for the purposes of this Act be deemed to be for a consideration equal to the market value of the asset –
>
> (a) where he acquires or, as the case may be, disposes of the asset otherwise than by way of a bargain made at arm's length…

TCGA s.18(1) and (2)

> (1) This section shall apply where a person acquires an asset and the person making the disposal is connected with him.
>
> (2) Without prejudice to the generality of section 17(1) the person acquiring the asset and the person making the disposal shall be treated as parties to a transaction otherwise than by way of a bargain made at arm's length.

THE REASONABLE SENIOR ACCOUNTING OFFICER

By Nikhil V. Mehta

Eight years after the tax reporting regime for Senior Accounting Officers ("SAOs") was introduced, we have had our first tax case regarding the imposition of penalties on a SAO for failing to comply with his obligations under the regime. The First-tier Tribunal's decision is notable for several reasons. The matter had a number of odd facts which, to put it bluntly, meant that the odds were stacked against the taxpayer, a Mr Kreeson Thathiah. Despite that, Mr Thathiah, who appeared in person, successfully managed to get the penalties levied on him discharged. The fact that HMRC lost is noteworthy in itself, given that the subject-matter relates to allegedly errant taxpayer behaviour, where it would be surprising for a taxpayer to win given the checks and balances HMRC take before beginning litigation. But despite HMRC's contentions, the Tribunal found the taxpayer's behaviour acceptable.

The SAO regime was introduced by the Finance Act 2009. It imposes duties on SAOs of large companies or corporate groups. The facts in the tax case involve a group, not a single company so I will refer to groups from now on. The SAO is defined as the officer or director who, in the company's reasonable opinion, has overall responsibility for the group's financial accounting arrangements. Commonly, this is the group finance director.

The "main duty" of the SAO requires him to take "reasonable steps" to ensure that the group establishes and maintains "appropriate tax accounting arrangements". These are defined as arrangements that enable all group companies' tax liabilities to be calculated accurately in all material respects. This means the affairs of each individual group company, since we do not have the concept of consolidation for tax purposes. More specifically, the SAO must take reasonable steps to monitor the arrangements and to identify any deficiencies. He is then required to provide an annual certificate to HMRC either saying the arrangements in place are “appropriate” or, if not, to explain why. If a SAO fails to comply with the main duty, he is personally liable to a penalty of £5,000. However, no penalty can be levied if the SAO can show he had a “reasonable excuse” for the failure.

Mr Thathiah had been employed as the finance director of the Lenlyn group. The group included a company called International Currency Exchange plc (“ICE”). The Tribunal noted that neither party had provided much information about the business of the group, except that it was engaged in providing financial services. For VAT purposes, financial services generally involve the making of exempt supplies, which in turn restricts the ability of the group to recover VAT on its input supplies. The group was, therefore, partly exempt and operated a partial exemption special method (“PESM”) for recovering VAT on its inputs.

The taxpayer provided the statutory certificates for the group for 2011, 2012 and 2013. These were all unqualified i.e. they made no mention of any shortcomings in the accounting arrangements. But he left the group in 2014. After he left, the group’s accountants, KPMG, made an error correction notification to HMRC in relation to ICE’s VAT affairs. This related to errors in ICE’s VAT returns between 2010 and 2014. As a result of the errors, the overall increased liability was £1.4m. During the relevant years, Mr Thathiah was the SAO and had signed the certificates.

Despite severing his connection with the group, in 2015 Mr Thathiah agreed to meet HMRC to discuss the errors. No-one from the Lenlyn group attended and, indeed, the taxpayer received no help at all from his former employer. HMRC were also not forthcoming about the nature of the errors notified by KPMG. They refused to show him the error correction notices. They cited taxpayer confidentiality as a reason for non-disclosure. Mr Thathiah was faced with having to answer allegations regarding his failures without being given the chance to understand the basis of the allegations. Despite this odd state of affairs, HMRC appear to have placed great significance on his inability to offer credible explanations at that meeting. Later that year, HMRC issued two penalty assessments on him for £5,000 each for 2012 and 2013 in relation to the VAT errors. As the Tribunal noted, the amount at stake was modest, but there were clearly reputational risks for the taxpayer if the penalties stuck, as well as damage to his employment prospects; the latter was particularly pertinent given he had left the group.

HMRC had taken the view that the taxpayer had not taken reasonable steps to ensure that the VAT accounting arrangements for ICE were proper.

The main thrust of HMRC's case was that the taxpayer had failed to put in place a system to test selectively whether figures in ICE's VAT returns, or relating to individual transactions, were correct. Rather, he relied simply on comparing figures with those in previous years' returns. This failure amounted to reasonable steps not being taken, and therefore a breach of the main duty, so HMRC said.

The Tribunal found that, although given limited resources by his former employer, the taxpayer had made a number of improvements and introduced processes during his time in that employment in relation to the group tax function. He established a small team comprising a tax manager and a group financial controller, who was a qualified accountant. Both had been provided with suitable training for their functions. They reported to him. He arranged for external support to be provided by KPMG. In particular, KPMG had negotiated the PESM with HMRC and were key in providing the VAT function to the group since there were no internal VAT specialists. He introduced a group tax policy document. He had asked his employer for more resources, but his requests had been rejected.

The Tribunal found that there was gradual improvement to the tax function against a "backdrop of limited resources and repeated requests by [the taxpayer] for additional resources."

There were, therefore, no defects in overall procedures or delegation which could have justified penalties. The issue boiled down to the narrower question whether the failure to do selective testing for VAT amounted to a failure to take reasonable steps.

Mr Thathiah argued that he had done whatever he could with the resources available. He delegated the VAT compliance function to his tax manager, who was supervised by the group financial controller. He relied on KPMG's detailed work in agreeing the PESM with HMRC and on the checks they made as part of the annual audit. He also took comfort from the open dialogue with HMRC's own VAT specialist in connection with the application of the new PESM.

The Tribunal found the taxpayer's arguments convincing and decided that HMRC had not satisfied their onus of showing that the lack of selective testing meant that the taxpayer had failed to take reasonable steps in relation to ICE's tax accounting arrangements.

The key to the case's outcome lies in the following sentence from the decision of the Tribunal (Judge Sarah Falk):

"The question of whether the appellant took "reasonable steps" is clearly an objective one, which in my view must be determined by reference to all the circumstances."

This shows that, despite the objective nature of the wording, there is an element of subjectivity, because the "reasonableness" has to be determined in the context of the relevant circumstances, and not by some higher standard based on a hypothetical corporate group. Further, one should have regard not only to the size, nature and complexity of the group's affairs, but also to facts relating to the SAO's situation and his ability to operate the tax function and whether that ability was hampered by constraints outside his control.

One needs to be clear, however, whether an individual's conduct amounts to taking reasonable steps on the one hand, or failing to take reasonable steps but having a reasonable excuse for doing so. Both routes avoid a penalty, but the way you get there is different. For example, another way of looking at Mr Thathiah's situation might have been to say that the failure to carry out selective testing was a failure to take reasonable steps. But given the resources at his disposal, he had a reasonable excuse for that failure. It is pertinent to note that in the legislation, it is expressly provided that an insufficiency of funds is not a reasonable excuse unless attributable to events outside the SAO's control. Mr Thathiah's inability to expand the internal accounting function was a constraint outside his control and could be viewed as a reasonable excuse.

While the result of either approach is the same i.e. no penalty, there is a fundamental difference in onus. It is for HMRC to show that reasonable steps have not been taken, but if they succeed, then it is for the taxpayer to show he has a reasonable excuse therefore. HMRC approached the case on the footing that reasonable steps had not been taken, so it was up to the taxpayer to show he had a reasonable excuse. But the Tribunal took the view that HMRC had failed in discharging their onus, so there was no need to consider whether there was a reasonable excuse. The Judge did, however, comment that the insufficiency of resources might have been sufficient to show a reasonable excuse, had that point been a live one.

The Tribunal were clearly concerned with how Mr Thathiah had been treated by HMRC and made some further observations:

- The taxpayer's treatment at the 2015 meeting was unfortunate, as was the fact that he was not given sufficient detail of the allegations against him until a late stage in the appeal. The Tribunal described this treatment as "unfair", and one might speculate as to whether aspects of HMRC's decision-making process might not have been subject to judicial review. Happily for Mr Thathiah (at least thus far as it is not known whether HMRC have asked for leave to appeal), this route was unnecessary, but certainly some of HMRC's conduct was questionable;
- HMRC failed to make sufficient allowance for the fact that the taxpayer was unrepresented;
- HMRC's evidence and arguments failed to draw any distinction between different sizes of partly exempt financial services businesses; it was critical to have a look at the actual circumstances, and not to apply some sort of industry gold standard for measuring reasonable steps;
- HMRC focussed too much on whether the taxpayer had a "reasonable excuse" for his actions without fully considering whether they had discharged their onus of showing no reasonable steps.

The Tribunal's approach confirms that, from the SAO's viewpoint, the better strategy with HMRC is to challenge the assertion that reasonable steps were not taken, rather than to accept that and then rely upon a reasonable excuse to get off the hook. This of course presupposes that the SAO has good evidence of appropriate behaviour to back his position. It is particularly important to get the approach right as it is possible for one person to view a pattern of behaviour as a reasonable step, but for another to see it as an unreasonable step for which there may be a reasonable excuse. The problem with the latter is a practical one: once HMRC have discharged their onus and the SAO's conduct found to be wanting, justifying that conduct becomes much harder.

It is not known whether the case will go on appeal. From HMRC's viewpoint, it may not be advantageous to take it further, given the strong findings of fact made by the Tribunal in favour of the taxpayer. It cannot also be in their interests to advertise further their behaviour when it has come under criticism by the Tribunal. The implications of HMRC pursuing a SAO of a group after he has left his employment are also problematic. It is clearly unsatisfactory for such an individual to be under investigation for inappropriate conduct in the past and for him also to be told that he cannot see the basis of the investigation because of taxpayer confidentiality. Mr Thathiah was caught between a rock and a hard place since his former employer also offered no help. If HMRC decide to take action against other individuals who have left their SAO-related employment, they clearly need to find a satisfactory way of treating such individuals even-handedly. It would not be surprising for other taxpayers in this situation to act without professional representation since the pecuniary amounts at stake are small. But this makes it even more critical for HMRC to be constructive in their dealings with the taxpayer.

If the decision becomes final without further appeal, it may not have precedent value, but it will be a helpful reminder that it is important not to put the "reasonable excuse" cart before the "reasonable steps" horse. It is also important for HMRC to be reasonable.

TAX LAW AND THE SUPREME COURT

By Nicola Shaw QC

It can sometimes seem as though tax law is an isolated dominium of special rules to which neither common sense nor ordinary legal principles apply. However, in *R (Ingenious Media Holdings plc) v Comrs for HM Revenue and Customs*,[1] the UK Supreme Court ('the Court') welcomed the general body of taxpayers into the bosom of the common law in an action concerning the duty of confidentiality owed by HM Revenue and Customs ('HMRC'). In tax law, that duty is enshrined in s 18(1) of the Commissioners for Revenue and Customs Act 2005 ('the CRCA 2005') but it is subject to s 18(2), which permits the disclosure of information for various purposes, including where the disclosure 'is made for the purposes of a function of [HMRC]' under s 18(2)(a) of the 2005 Act. The primary question that arose was whether the disclosure of information relating to the tax activities of Ingenious Media Holdings plc by HMRC to The Times newspaper was permitted 'for the purposes of a function of [HMRC]' within s 18(2)(a) of the CRCA 2005. The information had been disclosed by the Permanent Secretary for Tax, David Hartnett, during an 'off the record' meeting with two financial journalists, and was subsequently included in two articles published by the newspaper a week later. The reason for disclosing the information was said to be to promote good relations with the financial press in order to disseminate HMRC's position in relation to elaborate tax avoidance schemes.

Although an action against HMRC had been brought by way of an application for judicial review, crucially, the Court held that HMRC (and public bodies in general) 'are not immune from the ordinary application of the common law, including in this case the law of confidentiality.'[2] Thus, the question of whether HMRC had breached their duty of confidentiality did not fall to be decided simply by reference to public law remedies and principles, as the courts below had thought.[3] The proper approach of the court was not limited to an assessment of the rationality of HMRC's behaviour. The proper approach was to consider whether the disclosure of information amounted to a breach of the duty of confidentiality, applying established principles of law to its own judgment of the facts.[4]

Allowing the appeal, the Court held that the information disclosed was confidential in nature and subject to the duty of confidentiality contained within s 18(1) of the CRCA 2005[5] and, more importantly, that its disclosure was not 'for the purposes of a function of [HMRC]' within s 18(2)(a) of the 2005 Act.[6] The words in s 18(2)(a) could not be interpreted as meaning 'anything which in the view of HMRC is necessary or expedient or incidental or conducive to or in connection with the exercise of the functions of the collection and management of revenue',[7] as HMRC suggested, because if that was right then a number of the specific permissions contained in s 18(2) of the CRCA 2005 would be otiose. Furthermore, the effect of such a construction would be to undermine the principle of legality whereby 'fundamental rights cannot be overridden by general or ambiguous words.'[8]

A taxpayer's right to confidentiality is *a fortiori* because 'the whole system […] involves that […] matters relating to income tax are between the commissioners and the taxpayer concerned' and that the 'total confidentiality of assessments and of negotiations between individuals and the revenue is a vital element in the working of the system'.[9] As such, the general wording of s 18(2)(a) of the 2005 Act could not be taken to override that fundamental right. Rather, the provision was to be narrowly interpreted as an exception permitting disclosure to the extent reasonably necessary for HMRC to fulfil its primary function, of revenue collection and management.[10]

Furthermore, the disclosure of confidential information in the present case could not be justified by the desire to promote good relations with the financial press[11] nor by its divulgence 'off the record': 'an impermissible disclosure of confidential information is no less impermissible just because the information is passed on in confidence'.[12]

Comrs for HM Revenue and Customs v Volkswagen Financial Services (UK) Ltd[13] concerned the second of two issues arising in the context of a claim for repayment of VAT on overhead costs incurred by Volkswagen Financial Services (UK) Ltd ('VWFS'), a finance provider within the Volkswagen Group. The overheads in question were attributable to VWFS's hire purchase business, a business which made both taxable supplies of cars and exempt supplies of finance. The substantive issue concerned whether a proportion of the overhead costs was recoverable as a 'cost component' of the taxable supplies of cars notwithstanding the fact that the overheads were not incorporated within the price of the car, but rather were incorporated solely within the price of the finance. That issue was referred by the Court to the CJEU on 27 March 2017.[14] The second issue was a jurisdictional question concerning the nature of the First-tier Tribunal's function on an appeal against a decision rejecting a partial exemption special method ('PESM'). The contention of HMRC was that in approving the PESM proposed by the taxpayer, the First-tier Tribunal was required to decide whether that method produced a fair and reasonable result and not simply to approve it by default, having rejected the PESM proposed by HMRC as a method which was not fair and reasonable. In rejecting HMRC's contention, the Court held that the First-tier Tribunal's role was flexible. It was entitled to adopt an inquisitorial role if appropriate. Equally, it was entitled to assume, especially in a case such as this involving substantial litigants represented by experienced counsel, that the issues for determination were restricted to those identified by the parties.[15]

Comrs for HM Revenue and Customs v Investment Trust Companies (in liq)[16] is the latest in a long line of cases concerning the intersection between claims for repayment of overpaid tax and the law of restitution.[17] The novelty in this case was that it concerned indirect claims, that is to say claims brought not by the taxpayers but by those who had ultimately borne the burden of the overpaid tax. The claims in question were brought by certain investment trust companies to recover amounts of Value Added Tax ('VAT') paid on the supply to them of investment management services and accounted for to HMRC by the investment managers after deducting any input tax chargeable on the investment managers' costs. As it transpired, the services ought to have been treated as exempt from VAT and the investment managers were entitled, by way of a claim under s 80 of the Value Added Tax Act 1994 ('VATA 1994'), to repayment from HMRC of the VAT accounted. Those claims were subject to two restrictions: first, the claims were subject to the limitation period of three years contained in s 80(4) of the VATA 1994; and secondly, the amount of overpaid VAT was to be offset by any input tax credited to the investment managers pursuant to s 80(2A) of the 1994 Act.[18] As a result, the Investment Trust Companies brought claims in restitution against HMRC for the VAT paid by them to the investment managers to the extent that such amounts had not already been recovered by the investment managers under the statutory scheme.

In a nutshell, the Court dismissed the claims on the basis that HMRC were not enriched at the expense of the investment trust companies.[19] It is impossible to capture the intricacy of the Court's reasoning in a case note of this nature, but a pithy outline of the plot is achievable. The starting point in the Court's analysis is to identify the extent of HMRC's enrichment as being the net amount of the VAT accounted for to them by the investment managers and not the amounts of input tax deducted by the investment managers. The amounts of input tax could not be regarded as amounts which enriched HMRC because the claims to recover those amounts proceeded on the basis that the supplies were exempt and, thus, there was no obligation on the part of HMRC to allow any credit for input tax.[20] As to whether that enrichment had been at the expense of the investment trust companies, the Court considered that 'usually', for the enrichment of a defendant to be at the expense of the claimant the parties will have dealt with each other directly,[21] although there are exceptions, such as where the agent of one of the parties is interposed between them or where the claimant discharges a debt owed by the defendant to a third party.[22] Outside of those situations, where the defendant does not receive a benefit directly from the claimant it will be difficult to maintain that the defendant has been enriched at the claimant's expense.[23] Furthermore, the Court rejected an approach to the question of whether there was enrichment at the expense of the claimant based on 'economic or commercial reality' as too 'fuzzy' a concept.[24] Thus, the transfers of value from the Investment Trust Companies to the investment managers and the transfers of value from the investment managers to HMRC could not be collapsed into a single transfer of value from the Investment Trust Companies to HMRC.[25] The Investment Trust Companies' right of action in restitution lay not against HMRC but against the investment managers.[26] In addition, the Court also held that s 80 of the VATA 1994 was inconsistent with a concurrent non-statutory obligation on the part of HMRC to repay amounts of overpaid VAT and, therefore, excludes the possibility of a common law claim in restitution by consumers, who ultimately bear the burden of VAT, against HMRC.[27] Finally, the Court held that the inability of the Investment Trust Companies to pursue a direct claim in restitution against HMRC was not incompatible with EU law because they had a common law right to restitution of the amounts against the investment managers, notwithstanding the fact that the investment managers would have had a defence of change of position for any amounts which they could no longer recover from HMRC because of the three-year time limit.[28]

Moving on, tax avoidance schemes are a perennially recurring subject matter in the Court, producing some of the most exciting jurisprudential developments in tax law. However, this year's example, *RFC 2012 Plc (in liq) v Advocate General for Scotland*,[29] is something of a disappointment in that regard. The scheme in question concerned payments made by Rangers Football Club ('the Club') to an employees' remuneration trust ('the Trust') on behalf of its players. On recruitment, the player's contract of employment would set out the terms of the employment and the salary which would be paid subject to 'pay as you earn' ('PAYE') and national insurance contributions ('NIC'). In addition, the player received a side-letter from the Club undertaking that it would recommend to the Trust that the player be included as protector of a sub-trust and to fund the sub-trust with the amounts agreed in the recruitment negotiations. The Trust then made loans to the players of the amounts contributed to it on behalf of the player which were repayable out of the player's estate on death. The aim of the scheme was to avoid the PAYE and NIC liabilities which would otherwise be due on payments of earnings by an employer. The issue identified by the Court was 'whether an employee's remuneration is taxable as his or her emoluments or earnings when it is paid to a third party in circumstances in which the employee had no prior entitlement to receive it himself or herself.'[30] Regrettably, the Court did not analyse the logically prior question as to whether the amounts contributed by the Club to the Trust constitute remuneration from the employment at all – the judgment simply proceeds on an assumption that they do.[31] Instead, the Court focused on whether it is necessary for an employee to receive the remuneration in order for it to constitute taxable emoluments[32] and it concludes, without much difficulty, that it is not, because neither the statutory provisions themselves nor the overarching purpose of the legislation suggest any such limitation.[33] It is, after all, elementary that the earnings from employment are no less earnings because the employee requests or agrees for them to be paid to a third party instead of to the employee.

Finally, in *Comrs for HM Revenue and Customs v BPP Holdings Ltd*,[34] the Court considered a case management decision of the First-tier Tribunal debarring HMRC from defending an appeal against a decision concerning the taxpayers' liability to VAT. The decision is ultimately unique to its facts but the Judgment of the Court is of general relevance in two respects. First, the Court held that an appellate court could interfere with such a case management decision only 'if it could be shown that irrelevant material was taken into account, relevant material was ignored […], there had been a failure to apply the right principles, or if the decision was one which no reasonable tribunal could have reached.'[35] Secondly, the Court held that all tribunals and appellate courts, particularly in the field of tax where the law is the same throughout the UK, should be wary of applying or relying on the procedural jurisprudence on the Civil Procedure Rules ('CPR') without also taking into account the relevant rules of the Scottish and Northern Irish courts.[36] However, in the present case, concerning the application of time limits and sanctions, neither the Upper Tribunal nor the Court of Appeal could find any justification for adopting a more relaxed attitude to that adopted by the English courts under the CPR and it was not for the Court to interfere with that guidance.[37]

Endnotes

1. [2016] UKSC 54, [2016] 1 WLR 4164.
2. ibid [28] (Lord Toulson (with whom Lady Hale, Lord Mance, Lord Kerr and Lord Reed agreed)).

3. cf *R (Ingenious Media Holdings plc) v HM Revenue and Customs* [2015] EWCA Civ 173, [2015] WLR 3183; *R (Ingenious Media Holdings plc) v HM Revenue and Customs* [2013] EWHC 3258 (Admin), [2014] STC 673.
4. *Ingenious Media* (n 1) [26] and [29] (Lord Toulson (with whom Lady Hale, Lord Mance, Lord Kerr and Lord Reed agreed)).
5. ibid [32].
6. ibid [36].
7. ibid [19].
8. ibid [19], quoting *R v Secretary of State for the Home Office, ex p Simms* [2000] 2 AC 115, 131 (Lord Hoffmann).
9. *Ingenious Media* (n 1) [17], quoting *R v Inland Revenue Comrs, ex p National Federation of Self-Employed and Small Businesses Ltd* [1982] AC 617, 633 (Lord Wilberforce).
10. ibid [19] and [23].
11. ibid [34].
12. ibid [30]-[31].
13. [2017] UKSC 26, [2017] STC 824.
14. Case C-153/17.
15. *Volkswagen* (n 14) [7] (Lord Carnwath (with whom Lord Neuberger, Lord Kerr, Lord Reed and Lord Gill agreed)).
16. [2017] UKSC 29, [2017] 2 WLR 1200.
17. See eg *Woolwich Equitable Building Society v Inland Revenue Comrs* [1993] AC 70. See generally Steven Elliott, Birke Häcker and Charles Mitchell (eds), *Restitution of Overpaid Tax* (Hart Publishing 2013).
18. *Investment Trust Companies* (n 17) [12]-[13] (Lord Reed (with whom Lord Neuberger, Lord Mance, Lord Carnwath and Lord Hodge agreed)).
19. ibid [32]-[74], see also [25]-[31] (in which the Court found that HMRC was not enriched to the extent of an additional, ‘notional’ amount).
20. ibid [30]-[31].
21. ibid [46].
22. ibid [48]-[49]
23. ibid [51].
24. ibid [59]-[60].
25. ibid [71].

26. ibid [73].
27. ibid [86]-[88].
28. ibid [93]-[94]. See Value Added Tax Act, s 80(4); cf Limitation Act 1980, s 32(1)(c).
29. [2017] UKSC 45, [2017] 1 WLR 2767.
30. ibid [1] (Lord Hodge (with whom Lord Neuberger, Lady Hale, Lord Reed and Lord Carnwath agreed)).
31. ibid [23] and [61].
32. ibid [36].
33. ibid [37]-[41].
34. [2017] UKSC 55, [2017] 1 WLR 2945.
35. ibid [21] (Lord Neuberger (with whom Lord Clarke, Lord Sumption, Lord Reed and Lord Hodge agreed)).
36. ibid [23].
37. ibid [26].

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