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TAX BRIEF

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WELCOME

In this edition of *Tax Brief*:

(a) I consider three cases (***Fisher, Davies,* and *Rialas***) on the subject of the **transfer of assets abroad** legislation (ITA 2007 s.720) and what we can learn from them;

(b) I look at HMRC's use of **COP9** and how practitioners and clients should **deal with the process**;

(c) I focus on another **IR35 case** (this time involving football referees) to see why it was that the **taxpayer won** this case;

(d) *Counsel's Opinion* – I give my opinion as to why it seems that in **tax avoidance cases the rule of law does not apply** to a large extent;

(e) In *Curmudgeon's Corner* I have a **Victor Meldrew** moment in relation to the **confusion** between **"alternate"** and **"alternative"**;

(f) In *And Finally* I have a look at the "**beyond reasonable doubt**" test which applies rarely in tax cases but which has been the subject of commentary elsewhere and some amusing letters in The Times.

Please let me have any comments and feedback. I would very much welcome this.

TRANSFER OF ASSETS ABROAD – *FISHER; DAVIES* AND *RIALAS*

Speed read

These three cases deal with the transfer of assets abroad rules. In the *Fisher* case it was held that the shareholders in a company could not be transferors; that betting duty was a tax; that the motive defence did apply; the transactions involved in moving abroad were bona fide commercial and were not designed for the purposes of avoiding liability to taxation – the motive defence seems strong again; the transfer of assets abroad did breach EU law in certain circumstances; and (yet again) the taxpayer lost on the question of discovery.

In *Davies* the deemed income received by the taxpayers did not carry with it an exemption afforded by a double tax treaty – *Strathalmond* distinguished (as it were).

In *Rialas* (again) the identity of a transferor did not include the individual assessed; tax mitigation was tax avoidance; there was a breach of EU law because the s.739 provisions were penal in their denial of the EU principle of free movement

- The *Fisher* case - UT;
- The *Davies* case - UT;
- The *Rialas* case - FTT

The *Fisher* case

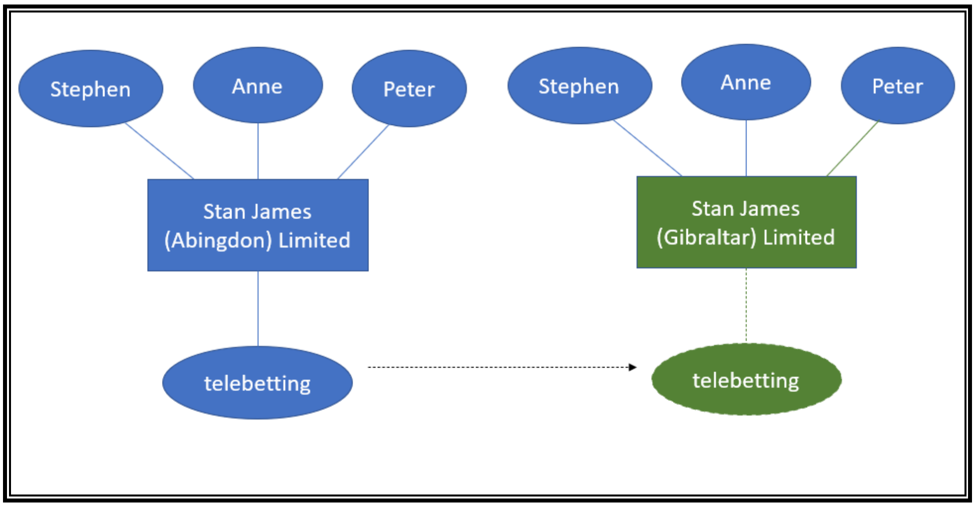
Speed read

The transferor in relation to a disposal by a company was not its shareholders; in the motive defence the commercial test is winnable; a breach of EU law can be claimed by a related party (here a husband); in relation to discovery the fullest information must be given and where s.739 is involved that must be fully stated in the white space.

Facts

The decision of the Upper Tribunal ([2020] UKUT 62 (TC)) in this case repays careful reading as it is extremely detailed and runs to 64 pages. The basic facts, however, were that the Stan James betting business was owned by a UK-resident company called Stan James (Abingdon) Limited ("the UK company"). In March 2000 the tele-betting business carried on by the UK company was transferred to a Gibraltar company called Stan James Gibraltar Limited ("the Gibraltar company"). The reasons for this transfer follow in this article.

The shareholders of both companies were Stephen and Anne Fisher (husband and wife) and their son Peter.



In due course, profits arose to the Gibraltar company and the question arose as to whether those profits were subject to tax in the hands of the three appellants pursuant to the transfer of assets abroad code the charge in relation to which is principally found in the Taxes Act 1988 s.739 and the Income Tax Act 2007 s.720.

The First-tier Tribunal had found that the three appellants were *quasi-transferors* and that the transfer of assets abroad code did apply to them in respect of the profits made by the Gibraltar company.

That Tribunal had also found that the motive test in the Taxes Act 1988 at s.741 (and in the Income Tax Act ss.737, 739 and 740) was not available because the transfer had been designed for the main purpose of avoiding liability to pay betting duty which the First-tier Tribunal had considered was a tax.

In relation to breach of EU law, which all three appellants submitted applied to them, the First-tier Tribunal had found that whilst Anne Fisher's rights of freedom of establishment had been compromised on the basis that she was an Irish national nevertheless that her husband and son's similar rights had not been compromised. This was principally because the transfer by Stephen and Peter Fisher involved an "internal" transfer from one UK jurisdiction (the UK itself) to another UK jurisdiction (Gibraltar): the EU provisions were not engaged.

As a further separate issue, there had been the question of whether discovery assessments made by HMRC in relation to the tax returns made by Stephen and Anne Fisher for the years 2005-06 and 2006-07 were validly made by HMRC pursuant to the Taxes Management Act 1970 s.29. The First-tier Tribunal had found that the discovery assessments were in each case *invalid*.

The First-tier Tribunal decision which was appealed

In a nutshell, the First-tier Tribunal had found as follows:-

(a) Anne Fisher's appeals for all material periods were allowed on the basis that her EU rights were prejudiced;

(b) Stephen Fisher's substantive appeals were dismissed on the basis that the transfer of assets abroad rules applied, the motive defence was not available and there had been no breach of his EU rights. In relation to the two years which were subject to the discovery assessments the First-tier Tribunal, however, allowed his appeal on the basis that those discovery assessments were not validly made; and finally

(c) the First-tier Tribunal dismissed Peter Fisher's substantive appeals but, as an aside, they held that an early assessment (for 2002/03) was out of time and this decision was not appealed.

FIRST-TIER TRIBUNAL PREVIOUSLY HELD

a) all appellants were *quasi-transferors* (overturned by UT);
b) the motive defence was unavailable (designed to avoid betting duty – therefore the defence did not apply) (overturned by UT);
c) breach of (freedom of establishment) for Anne (upheld by UT) but not for Stephen (overturned by UT) nor Peter (upheld by UT);
d) various HMRC discovery assessments were invalid – there was enough information (overturned by UT)

The legislation

It may be helpful to have the legislation to hand. The Tribunal considered the 1988 legislation rather than the Income Tax Act 2007 and therefore that earlier legislation now follows:

> "**739 Prevention of avoidance of income tax**
>
> (1) Subject to section 747(4)(b), the following provisions of this section shall have effect for the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfers of assets by virtue or in consequence of which, either alone or in conjunction with associated operations, income becomes payable to persons resident or domiciled outside the United Kingdom.
>
> (1A) Nothing in subsection (1) above shall be taken to imply that the provisions of subsections (2) and (3) below apply only if –
>
> (a) the individual in question was ordinarily resident in the United Kingdom at the time when the transfer was made; or
>
> (b) the avoiding of liability to income tax is the purpose, or one of the purposes, for which the transfer was effected.
>
> (2) Where by virtue of in consequence of any such transfer, either alone or in conjunction with associated operations, such an individual has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a person resident or domiciled outside the United Kingdom which, if it were income of that individual received by him in the United Kingdom, would be chargeable to income tax by deduction or otherwise, that income shall, whether it would or would not have been chargeable to income tax apart from the provisions of this section, be deemed to be income of that individual for all purposes of the Income Tax Acts.
>
> (3) Where, whether before or after any such transfer, such an individual receives or is entitled to receive any capital sum the payment of which is in any way connected with the transfer or any associated operation, any income which, by virtue or in consequence of the transfer, either alone or in conjunction with associated operations, has become the income of a person resident or domiciled outside the United Kingdom shall, whether it would or would not have been

> chargeable to income tax apart from the provisions of this section, be deemed to be income of that individual for all purposes of the Income Tax Acts."

HMRC's two-fold cross-appeal

In addition to the appeal by the appellants HMRC cross-appealed in relation to two aspects. First, then contended that Anne Fisher's rights were not prejudiced as a matter of EU law and, secondly, they argued that the relevant discovery assessments had been validly made.

Four principal issues

There were four principal issues:-

issue 1 – was the transfer of assets abroad code engaged?;

issue 2 – was the motive defence available?;

issue 3 – does the transfer of assets abroad code breach EU law?; and

issue 4 – in relation to Stephen and Peter were there valid discovery assessments?

I deal with each of these issues in turn.

Issue 1 – was the transfer of assets abroad code engaged?

This issue was itself sub-divided into three separate issues each of which I deal with now.

Issue 1(1) – can s.739 apply in a case where there is no avoidance of income tax?

This question essentially focused on the provisions of s.739(1A). Although the Tribunal had some difficulty with this subsection it seems relatively straightforward. The point is simply that it is not open to taxpayers to say that the transfer of assets abroad rules do not apply "in the first place" if there is no tax avoidance to start with. If that were the case then it would follow that s.739 would not even need to be considered – the absence of tax avoidance would rule consideration of that legislation otiose. That argument, however, in my view, is to "put the cart before the horse" as it were and is plainly wrong. The transfer of assets abroad code applies "in theory" in any event in the first place and it is only when "you reach" the motive defence that you can then apply any sort of non-avoidance defence. So you are in s.739 whether you like it or not and then you have to get out of it – via the motive defence – if you can.

The Tribunal agreed with the above and came to the conclusion (perhaps not surprisingly) that s.739 is capable of applying *ab initio* even in the situation where a taxpayer – as it turns out – was *not seeking to avoid income tax* by making the relevant transfer.

> *Can s.739/720 apply in a case where there is no avoidance of tax? Yes and no – you have to get into s.739/720 before the motive defence gets you out. It is not a "block" on entering.*

As we will see later on, there was a related question about whether avoiding betting *duty* is the same as avoiding *tax* but this is dealt with within the motive defence discussions themselves.

Issue 1(2) – is it possible to impute the transfer by the UK company to any of the taxpayers?

It will be recalled that the transfer of the business was effected by the UK company and not by any of the shareholders. So the question arose as to whether s.739 (which applies to a specific transferor) could apply on the basis, so it was argued, that the transferor was not any of the three taxpayers but was the UK company. The Tribunal principally considered the *Vestey* case (*Vestey v. IRC (Nos.1 & 2)* [1980] AC 1148) and the *Congreve* case (*Congreve v. IRC* [1948] 1 All ER 948) as well as the *Pratt* case (*IRC v. Pratt* [1982] 57 TC 1). They also addressed the time-honoured case of *Salaman v. A Salaman & Co Ltd* ([1897] AC 22) which, of course, deals with the separateness of a company from its shareholders. The most interesting consideration from my point of view was their analysis of the *Pratt* case. This has often caused problems particularly where there is a company with a single shareholder. *Can it be said, for example, that a single shareholder in a company is effectively the transferor under the transfer of assets abroad code, even if the relevant transfer is, as a matter of fact, effected by the company.* The Tribunal came to the conclusion that here, the transferor was actually the UK company itself and not the three individual shareholders. It could not be said that they were "quasi transferors" nor that they had "procured" the transfer. Again, this seems to me to be the right answer but it has often been a concern in relation to many situations that HMRC would indeed argue that the shareholders of a company are effectively the transferors. Indeed this was the (wrong) decision handed down by the First-tier Tribunal; they were incorrect to say that the appellants were quasi transferors.

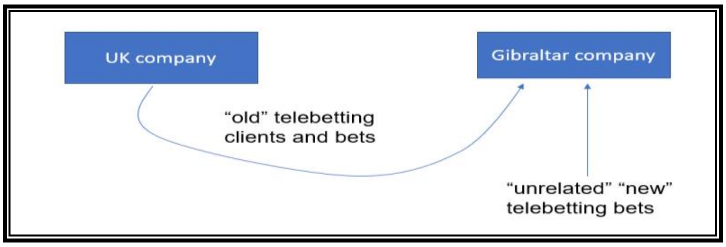
Vestey, Congreve, Pratt, Salamon v. Salamon all mentioned

Accordingly, the Upper Tribunal reversed the decision of the First-tier Tribunal on this front. Specifically, the Upper Tribunal held that the "mistake" that had been made by the First-tier Tribunal was to consider that the acts of the three individuals were equivalent to procuring the UK company to do something; when, in fact, the acts were carried out *for and on behalf of the company*. More particularly, it was held that it was not possible to *impute* the transfer by the company to any of the taxpayers in this case as "quasi transferors".

That meant, of course, that the individuals won the appeal. Section 739 could not apply to them because they were not the transferors.

It was still necessary to consider some of the other issues, in case the matter goes on appeal.

Issue 1(3) – did all the income of the Gibraltar company derive from the transfer by the UK company?



The essential point here was that it was argued that once the transfer had taken place *new* profits arose from the business that was then carried on: were those new profits caught by s.739 or did they "have nothing to do with" the avoidance with which s.739

was targeted bearing in mind (so it was essentially argued) that the avoidance occurred "once" (the transfer to Gibraltar) and could not be imputed to what happened later.

The Upper Tribunal found for HMRC here: specifically they did not overturn the First-tier Tribunal's finding that there was a sufficient nexus between the transfer and associated operations and the new income to bring that new income into charge.

Issue 2 – is the motive defence available?

This is probably the most interesting area because the Upper Tribunal was prepared to split out the two parts of the motive test in line, of course, with the two parts of the legislation at s.741. The Upper Tribunal was further prepared then to say that even if the taxpayers failed on the first limb of the motive test (*there was a tax avoidance motive*) nevertheless those taxpayers could still succeed on the second limb (*commercial defence*). Putting the position colloquially, the second limb provides that if there is a commercial purpose that "gets you home" provided that the design of those transactions was not to avoid tax.

I now repeat the wording of the motive test found in s.741:

> "if the individual shows in writing or otherwise to the satisfaction of the Board either –
>
> [First limb]
>
> (a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected; or
>
> [Second limb]
>
> (b) that the transfer and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation."

Is betting duty a tax?

The Tribunal first considered how the motive defence would apply in the case of multiple quasi transferors including, in particular, Anne Fisher who by virtue of the EU position could not be subject to s.739. Can it apply to more than one transferor? The Tribunal held that in the situation under review all three could have the motive defence available to them at least in theory.

The next question was whether there was *avoidance* of betting duty (on the basis that it was a tax). As is so often the situation, the case of *Willoughby* (*CIR v. Willoughby & anor* (HL 1997 70 TC 57)) was considered. In that case, Lord Nolan had come to the conclusion that there was a difference between tax avoidance which was unacceptable and tax mitigation which was not.

Mitigation is now the same as avoidance

That distinction is very largely "out of fashion" but in the *Fisher* case the proposition was put forward by the appellants that whilst there was a desire to *mitigate* tax (the betting duty) there was *no avoidance* motive.

The Tribunal held, however, that in the situation under review there was, as a general proposition, an avoidance of betting duty.

So, the next question was whether betting duty was taxation and the Tribunal held that it was.

First limb of the motive test - avoidance

In respect of the first limb, the Upper Tribunal held that there was avoidance of tax and therefore the first limb of the defence could not apply.

Second limb of the motive test – designed for tax avoidance?

Accordingly, moving on from this, this issue was whether the relevant transactions, which it was held were bona fide commercial, were *designed* for the purpose of avoidance. This therefore was in relation to the second limb of the motive defence (s.741(b)). Here the Tribunal found for the appellants.

In essence, they decided that there had been a commercial decision to move abroad. That decision was to save the business given the growth of tele-betting in the UK and elsewhere. The fact that there was a tax benefit from so doing was incidental and not instrumental in relation to the move. The transfer had not been designed for the purpose of avoiding liability to taxation. *It had been designed to save the business.* Moreover, it was clear that the impetus for the transfer of the business to Gibraltar included a concern about exposure to criminal sanctions under UK law and by far the most efficacious step to take was to conduct the offshore betting arrangements through a corporate entity which was separate from the UK company. In other words, the transfer was principally commercial and not designed for tax avoidance.

Did the second limb help?

Bona fide commercial transactions – not designed for the purpose of avoiding liability to taxation

Yes – they won on this head. The transfer was not designed for the purpose of avoiding liability to taxation.

Issue 3 – does the transfer of assets abroad code breach EU law?

This aspect of the decision repays very lengthy reading as the Tribunal went into great detail on the subject. For the purposes of this article it can be said that it was held that there was a breach of the fundamental right of freedom of establishment both for Anne Fisher (in her capacity as an Irish national) and for her husband (in his capacity as Anne Fisher's spouse) but not for their son who was entirely independent. So the wife and the husband won this argument but not the son.

The EU rights of Anne Fisher (an Irish national) were breached – freedom of establishment.

The husband's rights were also breached because he was entitled to rely on the rights of his wife.

His rights were like the company in Felixstowe Dock (ECJ Case C-80/12j [2014] STC 1489).

Peter the son was independent and therefore the EU breach did not apply to him.

The Tribunal approached the position by first looking at the rights of Anne Fisher who, as mentioned, is an Irish national. They confirmed the First-tier Tribunal decision that her rights of freedom of establishment had been breached.

They then took the interesting view as to how the fact that her rights were breached could impact upon her husband's ability to move abroad and separately her son's. They decided that the situation concerning the husband and the son should be dealt with separately.

In a nutshell, they decided that the husband's rights were breached because effectively he could "piggyback" his wife's argument. If her rights were breached by not being able to move abroad then so were his as he would want to move with her. In other words, he was entitled to rely on the rights of his wife. She might have been deterred from exercising her freedom to establishing a business in Gibraltar by the imposition of the code on her husband.

Specifically, the adverse impact on her freedom of establishment was neither justified nor proportionate as mentioned and there was a sufficient basis in EU law for allowing the husband to rely upon this position himself. Just as the restrictions in the *Felixstowe* case (*Felixstowe Dock & Railway Company Ltd v. HMRC,* ECJ case C-80/12j (2014) STC 1489 ("*Felixstowe Dock*")) of a UK company's ability to claim relief were a disincentive to the establishment of a link company in member states other than the UK, the negative tax consequences for the husband were a disincentive to the wife exercising her rights of establishment. It followed that Stephen Fisher's rights could be equated with the company in *Felixstowe Dock*.

The position for Peter Fisher (the son), however, was different because he was financially independent. He could move freely without consideration of how his mother's situation might impact on him: accordingly, his position was entirely different from his father's. Accordingly, he could not invoke this argument himself.

Issue 4 - discovery

The analysis of the discovery position went down a well-trodden route.

It is well understood that the law is found at TMA 1970 s.29.

Whereas the First-tier Tribunal had found that there was sufficient information in front of the hypothetical inspector the Upper Tribunal disagreed.

In particular, the fact that there had been an omission of any reference to relevant s.739 income in both the relevant returns negated any suggestion that the hypothetical officer should be taken to being aware of the existence of such income.

So this is an important message. The position should be spelt out in the white space.

> *Discovery assessments are very hard to counter unless the taxpayer has included the kitchen sink in their tax return*

Conclusion re Fisher

This case is like a thesis in its own right. The principal points which arise, in my view, however, are as follows:-

(a) the transferor in relation to a disposal by a company is almost always going to be the company itself and not its shareholders;

(b) the second part of the motive test is more benign than the first and if a real commercial rationale can be demonstrated and the transactions were not designed to avoid tax then the motive defence may be available;

(c) in relation to EU law it may be possible for one individual to piggyback the rights of another; and

(d) as far as discovery is concerned it is very important in the s.739 context that:-

   (i) s.739 Taxes Act 1988 (now ITA 2007 s.720) is referred to in the tax return;

   (ii) a specific claim under s.741 is made (now under ITA 2007 s.739) – also in the tax return; and

(e) the rules in relation to discovery have veered away from where they were originally intended to be. It is very difficult for taxpayers who are challenged on their substantive tax steps to argue that HMRC are out of time. The Tribunals will nearly always bend over backwards to bring out of time assessments back "into time" whatever s.29 may say if there is any element of avoidance. I suspect that the Tribunal considered that avoiders should not escape the consequences of their actions just because of what the Tribunal seems to see as a "technicality" into the making of timely discovery assessments.

The Davies case

> ***Speed read***
>
> The motive defence was not available and should in any event have been claimed; the exemption afforded by the double tax treaty at the level of the overseas recipient did not (for some reason) follow the deemed income to the individuals – this seems wrong; double tax relief should be claimed in a tax return even if it is "indirectly" available.

What it decided – treaty protection was not available under the TOAA rules

In the case of *Davies & Others v. HMRC* ([2020] UKUT 67 (TCC)) the principal point was as to the relevance of a double tax treaty in the context of the transfer of assets abroad legislation.

I was counsel for the appellants in this case and as it is not to be appealed I am now in a position to comment.

The Tribunal decided that the income which was exempt, under the UK:Mauritius double tax treaty (the "treaty"), in the hands of the overseas recipient did not enure for the benefit of the UK taxpayers even though the income in question (in respect of which the exemption applied initially) was deemed to be the income ("warts and all") in the hands of the relevant individuals. The treaty was given effect by the Double Taxation Relief (Taxes on Income) (Mauritius) Order 1981 (SI 1981/1121).

The case seems wrongly decided

In my view the decision that exempt income under the treaty does not remain exempt when deemed to be received by someone else is wrong. More particularly, it is a misunderstanding of the way in which the treaty (and treaties in general) operate in these circumstances.

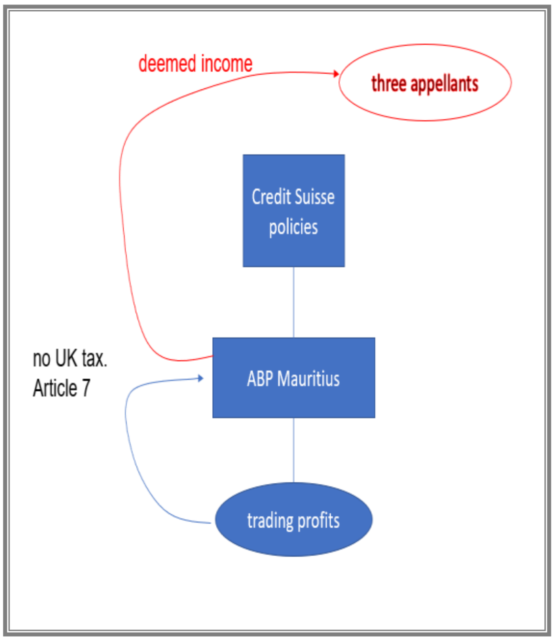
Treaties – particularly in relation to the business profits article – look to the particular income involved and apply relief to *that* income even if it is deemed to become the income of someone else. The exemption remains because it "attaches" to the income, in my view.

The Tribunal, instead, looked to the relevant separate persons and said that the taxpayers who were deemed ultimately to have received the income were not the same as the (initial) recipients. That is plainly the case. The Tribunal then went on to say that therefore those UK individuals could not have the benefit of the treaty. They were not the same persons to whom the treaty applied in the first place.

This in my view is not what treaties say and in in my opinion the decision is flawed.

The facts

Briefly, the facts were that three individuals (the appellants) were shareholders in a UK property investment company which acquired a property. Following exchange of contracts it became plain that the property in question was to be trading stock, rather than held as an investment, and therefore it was decided that completion of the transaction should not take place: the holding of a property which was trading stock, in an investment company, might taint the tax treatment of that company (*receipts taxed as gains not income profit*).



Accordingly, the three individuals were advised that a trading company should complete the purchase. Additionally, the opportunity was taken at the same time to make pension provisions for the three individuals. This was effected by arranging for the new trading company to be resident in a jurisdiction (Mauritius) which would benefit from double tax relief. Further, the shares in the company were attributed to three life policies which the individuals took out with Credit Suisse.

In other words, on the one hand the individuals would have pension arrangements in that the new Mauritian company should escape from UK tax on its profits and on the other hand the new Mauritian company could take over and complete the contract entered into by the investment company.

In due course other properties situated in the United Kingdom were bought and sold by the Mauritian company and the question arose as to whether the trading income, which arose from time to time to the Mauritian company, fell to be taxed under the transfer of assets abroad legislation in the hands of the three individuals. The relevant legislation was found in the Income and Corporation Taxes Act 1988 (Taxes Act 1988) at s.739 and subsequently in the Income Tax Act 2007 at s.720.

Three principal arguments

The taxpayers ran three principal arguments as follows:-

(a) the first was that the motive test should apply such that on the basis (so they argued) that there was an absence of tax avoidance the charging provisions within the transfer of assets abroad rules should not apply.

The motive test is found, in these circumstances, at Taxes Act 1988 s.741 and at Income Tax Act 2007 at ss.737, 739 and 740; and

(b) secondly their submission was, as mentioned, that the treaty operated to afford them an exemption from tax on the basis that the income was exempted in the first place and then deemed to be theirs. This position was changed in respect of income arising on or after 12th April 2008 (Taxes Act 1988 s.815AZA – now TIOPA 2010 s.130). From then on the treaty could not apply to any such deemed income;

(c) thirdly it was argued that since it had not been put to the witnesses at first instance that they had any avoidance motive it was wrong for the First-tier Tribunal to find that they had – this ground was lost by the appellants before the Upper Tribunal and I now focus on the other two principal arguments in turn.

Three arguments, viz:-

- procedural – HMRC had not put to any witnesses that their actions involved tax avoidance;
- motive defence – there was no avoidance; but there was pension planning, like *Willoughby*;
- the business profits article exempted the profits in the hands of the offshore company and that exemption "stuck to" the deemed income in the hands of the appellants under the TOAA rules (*Strathalmond*)

The motive test

The appellants' submissions in relation to the motive test were that the facts were on all fours with the facts of the *Willoughby* case (*CIR v. Willoughby & anor* (HL 1997 70 TC 57). In that case Professor Willoughby, as part of his retirement planning, had invested in a single premium bond with an Isle of Man company. Cutting a long story short, the Inland Revenue issued assessments to tax under what is now ITA 2007 s.720 on the basis that Professor Willoughby and his wife had sought to avoid income tax by the transfer of assets abroad: investing in the overseas bond. The House of Lords held that relevant transfers had not been made for the purpose of *avoiding* liability to taxation. As has already been mentioned, Lord Nolan said that there was an important distinction between "tax avoidance" and "tax mitigation" and that it would be absurd "to describe as "tax avoidance" (when Professor Willoughby opted for tax-efficient pension arrangements) the acceptance of an offer of freedom from tax which Parliament had deliberately made." More particularly, he said that tax avoidance should be construed as "a course of action designed to conflict with or defeat the evident intention of Parliament".

Pausing there, as an aside, the *Willoughby* judgment from 1987 shows just how much things have changed in the world of tax:-

The concern is that Willoughby is now past its sell-by date

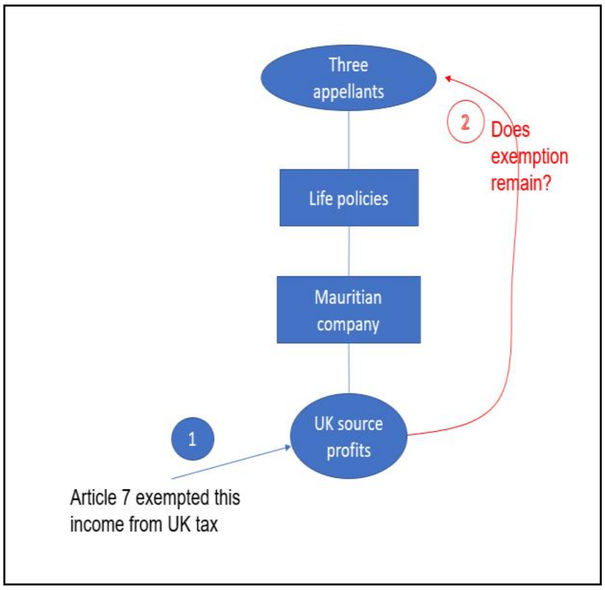
(a) the distinction between (unacceptable) avoidance and (acceptable) mitigation has all but gone – both are equally unacceptable. See, for example, the *Rialas* case which follows in this article. There, as will be seen, an attempt was made to argue that steps which were taken to mitigate inheritance tax were not avoidance for the purposes of the transfer of assets abroad rules: they were acceptable mitigation taking account of the case of *Beneficiary v. CIR* (SpC, [1999] SSCD 134 (SpC 190). This argument fell on deaf ears in *Rialas*; and

(b) (also in *Willoughby*) Lord Nolan refers to the "evident intention of Parliament" to support the notion of *acceptable* tax avoidance. It would be a brave judge now who would consider that the evident intention of Parliament could ever result in tax avoidance being acceptable.

Carrying on with the motive defence, in the *Davies* case, the three appellants argued that the use of the Credit Suisse policies – and the involvement of the Mauritian company – had been, in effect, to mirror the position of Professor Willoughby since the three individuals were themselves engaged in pensions planning. As such, the motive defence should apply, so the submissions ran, as it had in the *Willoughby* case.

The Upper Tribunal held that the particular circumstances of the case (by which completion of the property had not taken place by the investment company but instead by the Mauritian company) was evidence of a tax avoidance motive such that the motive defence did not apply.

The treaty argument



The second argument submitted by the appellants was that the treaty should have application. The contentions were that it exempted income in the hands of the Mauritian company in the first place and, accordingly, so it was submitted, that exemption should automatically flow through – under the deeming provisions within the transfer of assets abroad rules – to the three UK residents. This, after all, was on all fours with the *Strathalmond* case (*Lord Strathalmond v. CIR*, Ch.D 1972, 48 TC 537) as its implications were very clearly (and positively) set out by Millett LJ in *Bricom* (*Bricom Holdings Limited v. CIR*, CA 1997, 70 TC 272).

Cutting a long story short it was accepted by the Tribunal that, taking account of the treaty the business profits of the Mauritian company were to be accepted in Mauritius and nowhere else. This was because the treaty exempted those profits from UK tax in the hands of the Mauritian company. The question then was whether that exemption should enure for the benefit of the individuals pursuant to the provisions of the transfers of assets legislation which deemed *that* income to be theirs.

It is here that, in my view, the Upper Tribunal were in error in finding against the appellants on this aspect. The decision is not to be appealed however.

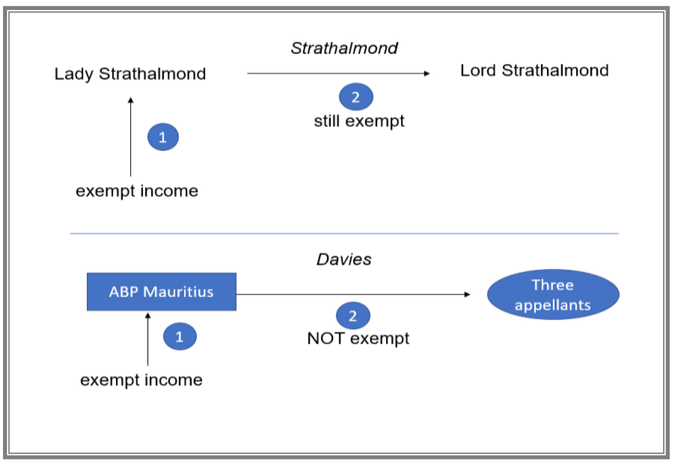
More particularly, the issue was whether the double tax treaty exemption applies to income rather than to the person. If the former (applying to income) the appellants would win; if the latter (applying to persons) HMRC would win. As far as I am aware this point (that you look to the persons not the nature of the income) has not been argued by HMRC before. In a nutshell, the appellants argument was that the exemption was automatically transferred to the appellants. After all, in the case of *Bricom*, it was common ground that the relevant article in that case exempted the interest itself and not merely the particular resident of the Netherlands who received the interest and indeed throughout the appeal in *Bricom* the Inland Revenue (as they then were) had accepted that the treaty protected the income in whosoever hands it was taxed. *Bricom* failed – however – for different reasons.

Further in the case of *Strathalmond* the income of a wife who was a US citizen was deemed under the rules then in play to be that of her husband. He was held, nevertheless, to be entitled to the treaty exemption as it applied to her as a US citizen. In other words, because the treaty exemption applied to the income of the wife in the first place when that income was deemed to be the income of the husband the exemption "stuck to the deemed income" and gave the husband the benefit of the exemption.

More particularly, it seems obvious that the treaty exemptions are not limited to persons in this case and can enure for the benefit of a third party and, as already mentioned, Millett LJ went to great lengths to explain how treaties operate in these circumstances and (in my opinion) made it plain that exempt income remains as such.

It is worth noting also that the Upper Tribunal said (in paragraph 65) that the purpose of the treaty (and treaties in general) was to confer relief against double taxation and not to confer double tax relief on the basis, so they assumed, that double tax relief was being afforded. That was not the case in the situation under review. The profits were taxable in Mauritius in any event. Thus, the treaty was not conferring two tranches of relief. It was conferring double taxation relief as treaties should.

Be that as it may, the case is not to be appealed but it is hoped that this aspect (that treaties of this nature apply to income and not to persons) will receive another airing at some point.



General overview

The case shows principally the following:-

(a) the difficulty of satisfying the motive test these days;

(b) leading on from this if individuals are claiming the motive test then they should make a declaration to that intent (in the white space on their tax return);

(c) the obtaining of double tax relief cannot apply to the transfer of assets abroad rules anyway since 11th March 2008; but

(d) it would be interesting to have tested the question of whether a double treaty exemption does continue to enure with the income or whether the fact there are different recipients rules out that possibility; and

(e) quite separately if ever double tax treaty relief is sought, however remotely, then a claim to that effect should be made with the relevant tax return to be on the safe side.

APPEAL LOST

- no procedural irregularity – the Tribunal may infer the position;
- no motive defence – the offshore company was needed for (separate) tax reasons – *Willoughby* distinguished;
- don't apply the treaty to deemed income – another (deemed) recipient cannot access the treaty (*Strathalmond* held not to be on the point for some reason)

The Rialas case

Speed read

Mr. Rialas was not the transferor in relation to a purchase by "his structure" from a third party; a desire to mitigate inheritance tax is now avoidance and therefore denies the availability of the motive defence; s.739 is incompatible with the EU principle of free movement of capital because of its penal effect.

The facts

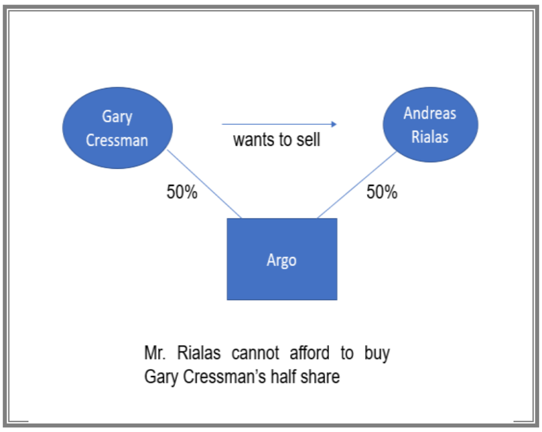
The *Rialas* case (*Andreas Rialas v. HMRC* [2019] UKFTT 520 (TC)) is another case which was concerned with the transfer of assets abroad rules.

The facts, briefly, were that Mr. Rialas was the 50% owner of a UK company called Argo Capital Management Limited ("Argo") together with Gary Cressman who owned the other half.

Business relations between the two became such that Mr. Rialas sought ways of acquiring Mr. Cressman's 50% shareholding in Argo but he was not able to afford this and there were other relevant issues.

Accordingly, a vehicle was necessary that could acquire Mr. Cressman's shareholding and, as a result, a trust was created by Mr. Rialas which became the beneficial owner of a BVI-incorporated company called Farkland Ventures Inc. ("Farkland").

A further important aspect of the creation of the trust was that it was intended to afford long term inheritance tax benefits and this fact became relevant in relation to the discussions of the motive test.

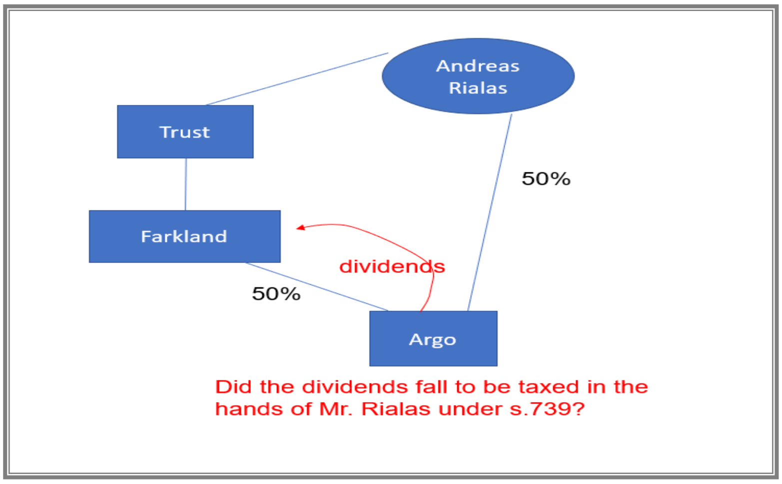


In due course, Farkland (the shares of which were vested in the trust settled by Mr. Rialas) borrowed sufficient ($15.3m.) to enable it to acquire the 50% shareholding of Mr. Cressman in Argo. So, Argo became owned as to half by Mr. Rialas and as to the remaining half by the trustees.

Some years later the entire issued share capital of Argo was sold to a third party.

After the purchase by Farkland of Mr. Cressman's half-share and before the onward sale to the third party, interim dividends were paid by Argo in the two years under appeal. 50% of those amounts (being those received by Farkland) were then assessed against Mr. Rialas under the provisions of the Taxes Act 1988 s.739. The interim dividends were substantial and were £2.1m. in the calendar year 2005 and £3.3m. in the calendar year 2006.

The principal issue for the First-tier Tribunal was whether s.739 applied: if it did then the whole of the dividends paid to Farkland would be subject to tax in the hands of Mr. Rialas.



In dealing with the s.739 question, there were three specific issues which fell to be dealt with by the Tribunal and these were as follows:-

(a) *was Mr. Rialas the transferor* (for s.739 purposes) in respect of the acquisition from Mr. Cressman of his 50% interest in Argo which was acquired by Farkland?;

(b) assuming that Mr. Rialas was the transferor *could the motive test within s.741 apply* to relieve him from the charge to tax under s.739?; and finally

(c) could it be said that the imposition of liability to income tax under s.739 would *infringe Mr. Rialas's right to free movement of capital* under Article 56 of the treaty establishing the European Union (2002)?

Was Mr. Rialas the transferor?

The key case in this area remains the case of *Vestey v. IRC* (54 TC 503) which held, in effect, that the transferor is the person who made the transfer or who may be was associated with the transfer itself. The notion, therefore, of a "quasi transferor" is not easily sustained nor is the notion of someone "procuring" a transfer and thereby becoming a s.739 transferor.

The point of all of this (*why did it matter if Mr. Rialas was the transferor*) was that following the defeat for the Inland Revenue in the *Vestey* case there followed the introduction of Taxes Act 1988 s.740. This "new" section deals with the position of individuals who were not the transferors but were still intended to be susceptible to the transfer of assets abroad legislation albeit by reference to different rules.

In addition, the case of *IRC v. Pratt* ([1982] STC 756) is important because the case considered the position of controlling shareholders: could it be said that even though a transfer was "actually" made by a company, the controlling shareholders had "procured" that transfer to such an extent that they became quasi transferors within s.739? As will be seen, in this case of *Rialas* this was dismissed as a possibility.

Moving on, in the case of *Cargill v. IRC* ([2000] STC (SCD) 143) the question there was whether it was acknowledged that for an individual to be the transferor in relation to a transfer made by somebody else would be a considerable extension of the basic principle (in s.739). Nevertheless, in *Rialas* it was stated that there might be cases where one individual's influence over another was so strong that he became the transferor of the other shares – but this would be exceptional.

The *Rialas* case finished off by looking at the First-tier Tribunal decision in the *Fisher* case. The Upper Tribunal had not then made its decision in *Fisher*. In the *Fisher* case, as already described, the First-Tier Tribunal (whose decision was overturned by the Upper Tribunal in *Fisher*) had found that it was possible for a transfer to have been procured and in those cases the person so procuring was a transferor. As mentioned, the Upper Tribunal in *Fisher* came to a different decision on the facts: the company in that case (Stan James (Abingdon) Limited) was the transferor and nobody else.

In the situation under review the First-tier Tribunal held that Mr. Rialas was not the transferor nor a quasi transferor of the shares and the reality was that, in effect, Mr. Cressman (rather than Mr. Rialas) was the transferor in respect of the sale of Mr. Cressman's 50% interest in Argo to Farkland.

That finding was therefore enough for Mr. Rialas to win his case: he was not the transferor – ergo s.739 could not apply to him.

The motive defence

Mr. Rialas did not need to win the motive test having now won on the first point but nevertheless the Tribunal considered that defence in detail.

The key point here was that although there were good commercial reasons which were put forward as to why the structure was needed the case turned on the fact that it was accepted that one of the purposes was to avoid inheritance tax. As before (with *Davies*) the case considered the ratio of *Willoughby* (*CIR v. Willoughby & anor* (HL 1997, 70 TC 57)) but did so in the context this time of the difference between an unacceptable tax avoidance as against acceptable tax mitigation.

The Tribunal was referred to the case of *Beneficiary v. IRC* ([1999] STC (SCD) 134) – to which I have referred above. In the *Beneficiary* case a taxpayer (albeit in a case over twenty years ago) successfully argued that setting up a structure to mitigate against inheritance tax was not the same as having the motive of unacceptable tax avoidance: mitigation of tax was then accessible.

However, the Tribunal in *Rialas* were taken to the more recent case of *Burns v. HMRC* ([2009] STC (SCD) 165), and the decision of Judge Nowlan. He had held that, in the particular situation, where it is shown that capital gains tax or inheritance tax considerations were amongst the purposes for the transfer, then that, by itself, involved tax avoidance rather than just tax mitigation. As was stated in the *Rialas* case the facts of *Burns* were on a par with the facts of *Rialas*. On this basis the Tribunal held that the interposition of a non-resident trust did have a tax avoidance motive and therefore the motive test found within Taxes Act 1988 s.742 was not available. It would have been interesting to see whether nevertheless the second limb of the motive test (the commercial test) might have been differently decided after all given the view adopted by the Upper Tribunal on this point in the *Fisher* decision. I doubt it.

Was there an infringement of Mr. Rialas' right to free movement of capital?

The final question to be considered (albeit that – like the motive test – it was academic given that Mr. Rialas was held not to be the transferor and therefore s.739 could not apply in the first place) was whether there had been a breach of the right to free movement of capital in any one of three situations, viz:-

(a) the sale by Mr. Cressman to Farkland of the shares in Argo;

(b) the payment of dividends by Argo to Farkland; and

(c) the gift by Mr. Rialas to the trustees of the initial trust capital.

The interesting point here was that HMRC argued that this protection was not available where there was tax avoidance. The appellant accordingly took the Tribunal to the case of *Cadbury Schweppes Overseas Limited and Cadbury Schweppes plc v. HMRC* (Case C-196/04) and by reference to that case tax avoidance was justifiable unless there was a breach of tax avoidance provisions in domestic legislation which caught arrangements which were effectively totally artificial. However, in a more recent case of *X GmbH v. Finanzandstuttgart-Korperschaften* (Case C-135/17) (the *Finanzandstuttgart* case), issued on 26th February 2019, the CJEU had held that the concept of wholly artificial arrangements could not be limited to the position described in the *Cadbury Schweppes* case: the concept of unacceptable avoidance was capable of extending to a scheme which had as its primary objective or one of its primary objectives (or one of its primary objectives) the artificial transfer of profits to third countries with a low tax rate.

Having considered *Finanzstuttgart* case the First-tier Tribunal stated, however, that not only was it necessary (to prevent the free transfer of movement defence to apply) for domestic anti-avoidance provisions to be justified they also had to be *proportionate*. Reference was then made to the case of *Stephen Hoey v. HMRC* ([2019] UKFTT 0489 (TC)) and the Tribunal went on to say that in their view the anti-avoidance measures within the transfer of assets abroad rules were *penal* in nature and therefore *not proportionate*.

Accordingly, it was held that the provisions of s.739 were not compatible with the EU principle of free movement of capital because they were penal in nature and therefore a disproportionate response.

In other words, the appeal was allowed and the following was held:-

(a) s.739 did not apply to Mr. Rialas because he was not the transferor;

(b) the motive defence was not available because of the desire to avoid inheritance tax; and

(c) s.739 was not compatible with the EU principle of free movement of capital because the provisions were penal in their effect and the only effective remedy therefore was to disapply s.739.

COP9

Speed read

The COP9 process is an investigation process used by HMRC where they consider fraud may be involved. It starts as a civil matter but can flip into a criminal one. So it needs to be handled carefully. Legal professional privilege is a critical tool for the taxpayer and should be accessed whenever possible. Clients need to be candid in their dealings with HMRC but also clients who have committed no fraud require sensitive and strong advisers.

Dealing with a Code of Practice 9 (COP9) investigation

The process, known as "COP9" is a form of HMRC investigation into a taxpayer's affairs. It is always a distressing matter for clients since HMRC contend that they instigate COP9 investigations where they consider that some form of fraud (including in particular tax evasion) may be involved. So, clients will be fearful just by dint of that fact alone. In addition, however, the process is alarming because it starts as a civil investigation but if the taxpayer "puts a foot wrong" then it can become a criminal one.

Accordingly, COP9 investigations need to be very carefully handled. This means, as a starting point, that practitioners with a good understanding of COP9 and/or criminal law need to be involved from the outset.

Furthermore, the whole question of legal professional privilege, it seems to me, is very important in the context of COP9 and is very often overlooked. The discussions which the taxpayer has with their advisers will benefit hugely from being privileged which is the case if the advisers are solicitors but not otherwise. It sometimes seems harsh that accountants are not able to afford their clients professional privilege and, if it were left to me, I would allow privilege to be available to accountants in certain areas including, in particular, COP9 investigations. Their discussions should be privileged given the seriousness of the allegations. The counter argument to this, however, is that solicitors (unlike accountants) are officers of the court and therefore their overriding duty is to the rule of law and the administration of justice and any breach can result in their being struck off. That is why (amongst other reasons) legal professional privilege applies to clients dealing with solicitors rather than accountants.

The whole question of legal professional privilege was considered by the Supreme Court in the case of *R (on the application of Prudential Plc) v. Special Commissioner (and related applications)*, SC [2013] UKSC 1; [2013] STC 376. The Supreme Court came to the conclusion (by a 5:2 majority) that privilege did not extend to accountants. Lord Neuberger observed that "where a common law rule is valid in the modern world, but it has an aspect or limitation which appears to be outmoded" [as the question of privilege in relation to accountants might be said to be] "it is by no means always right for courts to modify the aspect or remove the limitation. In any such case, the Court must consider whether the implications of the proposed modification or removal are such that it would be more appropriate to leave the matter to Parliament." He went on to say that the question of whether legal professional privilege "should be extended to cases where legal advice is given from professional people who are not qualified lawyers raises questions of policy which should be left to Parliament."

So, legal professional privilege is a key point.

The client will benefit greatly from legal professional privilege

Moving on, it is worth observing that, as a general matter, HMRC can instigate (without involving the COP9 procedure) a criminal investigation with a view to prosecution in any circumstances.

COP9, however, is a sort of halfway house since (as an investigation of fraud) it starts on a civil basis but of course it can become a criminal investigation in due course.

As part of the COP9 process, as a general view, the taxpayer is given the opportunity, within the process, to make a complete and accurate disclosure of all their deliberate and non-deliberate conduct that (in HMRC's eyes) has led to irregularities in their tax affairs. This disclosure is a very key aspect of the COP9 process since if HMRC consider that something is not fully disclosed then the COP9 procedure may, as mentioned, move to a criminal investigation which may end up with a criminal prosecution.

The key for the advisers therefore is to fully understand as soon as possible by discussions with the client what the area of concern may be: *why has the COP9 investigation commenced*?

In particular, advisers need to know if there has been any "deliberate conduct" and by this is meant that the client knew or is alleged to have known, for example, that an entry or entries in a tax return or a set of accounts were wrong and were still submitted; or that they knew that a liability to tax existed but they chose not to tell HMRC at the appropriate time.

Quite apart from the fact that the COP9 procedure may itself "flip" into a criminal investigation as mentioned, in addition criminality may follow if the COP9 process is not handled correctly. By this I mean that if the client makes materially false or misleading statements within the COP9 investigation itself then that fact may of itself trigger a different and separate criminal investigation. So care is needed at all times.

The difficulty with COP9 from the client's point of view is often just to understand why the investigation has commenced. In my experience, there are two sorts of clients: those who know that there has been some sort of a fraud and those that are clear that there has not.

Two sorts of clients – those that have committed fraud – COP9 will help them; those who have not; COP9 can be very stressful and frustrating

In relation to the former, the COP9 procedure can be helpful because it is a way of limiting the damage. In other words, if a full disclosure is made under COP9 then the proceedings remain civil not criminal. Whilst the sanctions can still be very financially punitive (payment of tax plus interest together with penalties which can be very high) this is not as bad as a criminal sanction.

Reverting to the client, however, who has no clue as to why the investigation has commenced and in particular why there is any suggestion of fraud, COP9 can be a very stressful and frustrating experience. It is here that good advice is needed and the client must remain firm and make sure that all the disclosures are accurate in the hope that, in due course, HMRC will agree that there is nothing untoward and the matter can then be resolved without any risk of criminal sanction and without any risk of penalties and other civil remedies.

Suspicion of fraud

The starting point in relation to COP9 is that HMRC must have received some sort of information to the effect that the individual may have committed tax fraud. There is a concern amongst practitioners that this may not always be an entirely justified concern. For example, in the world of transfer pricing, the COP9 procedure seems to me to be being used very freely and (perhaps unfairly) it does appear to be part of a procedure to alarm taxpayers engaged in international trading, albeit very often unnecessarily. This therefore is an area of concern.

In all the circumstances of a COP9 enquiry, a particular worry is that HMRC do not usually report to the taxpayer what their suspicions may be. So the taxpayer is in the dark but still must make a very full disclosure. This is why professional help is needed – to marshal that process.

Commencement of the COP9 procedure

On receipt of the information from HMRC that the COP9 process is starting it is important that the client contacts their advisers. It will be extremely helpful, as mentioned, if that team of advisers is able to afford legal professional privilege. This is particularly the case if the procedure turns criminal and as a matter of caution the advisory team must be prepared for that eventuality at the outset even if its seems unlikely. I say this because when dealing with potential criminality it is important that the advisers can be frank with their clients without the risk of such frankness automatically becoming disclosable.

The contractual disclosure facility (CDF)

The client will be offered the contractual disclosure facility which allows the client to disclose any loss of tax that has been brought about by a deliberate conduct and there is a 60-day period with which to respond.

This requires a full disclosure of all (if any) tax irregularities and the disclosure involves two stages.

The first is an outline disclosure of the deliberate conduct that brought about the tax loss and the second is a certified statement that the individual has made a full, complete and accurate disclosure of all tax irregularities together with certified statements of assets and liabilities and all bank accounts and credit cards that have been operated.

So, just pausing there the CDF is not particularly helpful if the individual is firmly of the view that no tax loss has been brought about by deliberate behaviour; perhaps the position is that there has been nothing more than careless errors or mistakes, or even nothing.

In the event, however, that there is full disclosure of any or all irregularities then there will not be any criminal investigation. The matter will remain a civil investigation albeit a serious one.

If it is suitable for HMRC to proceed with the contractual disclosure facility then a formal offer will be made which can be accepted within 60 days. This ensures that the matter will not be criminally investigated but this does not mean, as already mentioned, that there will be no other significant financial consequences.

For example, there may be significant tax to pay, there will be interest to pay; and there may be penalties as well and these can be quite significant.

On the subject of penalties, in the three years when I was authorised to represent HMRC as a barrister I had one significant penalties case which went to trial. HMRC were seeking a penalty of 80% for evasion in relation to VAT. The Tribunal expressed their disappointment that HMRC had not made a claim for a full 100% penalty. It needs to be said that HMRC are now much more inclined to seek penalties whenever they can and, of course, where overseas matters are involved the penalty can in certain circumstances be as high as 200% of the tax involved.

The penalty regime now is very penal!

Rejection

If the client is of the view that there has been no loss of tax brought about by deliberate conduct (because there has been no such behaviour) then a rejection letter should be sent within the same 60-day period.

If this is the case then HMRC will continue with its own investigations which can become criminal and therefore this is an important area.

If for some reason no reply at all is made within 60 days then HMRC will work on the basis that there has been a rejection. So at this stage of the COP9 procedure the client has the option to either accept the offer (to go the CDF route) or to reject the offer.

When would a criminal investigation start?

If the matter is rejected then a criminal investigation could start if HMRC are of the view that this is justified.

It could also start if the outline disclosure is not completely correct or not sent at all.

In this respect, false statements are absolutely to be avoided as is disclosure of false documentation – of course.

At the time that HMRC send the CDF offer letter they will also send an outline disclosure form which has to be completed to ensure that the outline disclosure is valid.

This would involve the client setting out precisely what had happened and giving full details and would include details of other individuals who were involve and the time period and so on.

After receipt of the outline disclosure HMRC may consider that it is unsatisfactory in which case they may start a criminal investigation. Alternatively, they may accept it in which case the next step (where acceptance takes place) depends upon whether the case is straightforward or complex. Where it is straightforward then, as mentioned, HMRC will seek to have all outstanding tax paid but they will need a formal disclosure to the intent that everything has been covered in relation to the individual's assets.

Those of us of a certain age remember a famous personality – namely Lester Piggott – purporting to disclose all of his assets but then reportedly settling the final tax bill on a cheque in respect of an overseas bank account that had not been disclosed – *bad idea*.

> *Lester Piggott allegedly signed the cheque to the Inland Revenue on an undisclosed bank account – bad idea*

In a complex case then there will need to be a full disclosure report which will include many more details. Once the matter is agreed there will be a certificate of full disclosure and again, as mentioned, it is critically important that this is looked at carefully and completed with the utmost honesty.

Liaising with HMRC

Throughout the process it will be important that HMRC are kept informed as to what the advisers and their client are doing. HMRC need to be assured that everything is being done as quickly and sensibly as possible and they need therefore to be "kept in the loop".

On the other hand, the client needs comfort from the advisers that their case is being properly marshalled where (as is often the case) the client is simply unaware of what HMRC's concern can be.

It is often the case that the client will be called by HMRC for a meeting during the process and this will occur typically once the outline disclosure has been submitted to HMRC. This is an opportunity usually for HMRC to go through the outline disclosure and also to gather some further background information. It can often be an opportunity to get more information from HMRC and to see where the matter is proceeding, i.e. in what direction.

The question is always whether the client should attend or just advisers. This will have to be a judgment case in each situation.

Generally

As already mentioned, one of the big difficulties for advisers and clients is simply that often there is no way of knowing what it is that HMRC are looking into investigating and what documents they have seen which have given rise to their concern. Often a COP9 investigation can relate to many previous years and many transactions and the paperwork may be extensive. It is important that the advisers are given the client's documents as soon as possible in order that the advisers can see for themselves what may be the concern that HMRC have identified. It is also important that that the client is interviewed carefully by their advisers and, where relevant, as mentioned, that a criminal law expert is involved to ensure that the client fully understands what is happening and understands the process and is also protected (having regard to privilege again) at the outset if the matter does become a criminal one.

It is often the case that the matter is settled along civil lines then there will still be issues as to penalties and the more co-operative that the client and the advisers have been through the process the more likely the penalties are to be minimised (see TMA 1970 s.34 coupled with s.29 (four years – the ordinary time limit) and s.36 again coupled with s.29 (six years - careless behaviour and twenty years – deliberate conduct)).

If, as is also the case from time to time, HMRC have simply "got the wrong end of the stick" then the matter may proceed to being settled in the usual way – perhaps without any interest and certainly without penalties.

In this respect, as mentioned in passing, it is worth remembering that time limits apply. So it may be that HMRC will be mindful of the need for them to get assessments in on time and if, for example, the four-year period under s.34 has passed it will be much more difficult for HMRC to bring late assessments on the basis that there has been careless behaviour (six years) or deliberate behaviour (20 years).

HMRC's assessment time limits

initial period – one year

normal "longstop period" – four years

carelessness – six years

deliberate behaviour – twenty years

Conclusion

The COP9 process is alarming. It needs to be handled carefully from the outset. The client must be 100% encouraged to be fully candid but if the client remains adamant that there is no criminal activity then this aspect must be at the forefront of the advisers' minds in relation to their task to bring a satisfactory closure to the enquiry.

It is definitely the case that the team of advisers should include experts with a criminal law background if at all possible together with those with a tax expertise plus, of course, those with expert knowledge of how the COP9 process operates.

ANOTHER EMPLOYMENT:EMPLOYEE CASE

Speed read

The Professional Game Match Officials Limited case is helpful in looking again at the mutuality of obligation test. It is relevant in determining whether a contract is one of employment or self employment. If the putative employer is not obliged to provide work or remuneration instead then there is unlikely to be a contract of employment. In relation to control the "step in test" was briefly considered. This is where the employer has the right to "involve itself" in relevant matters.

HMRC v. Professional Game Match Officials Limited ([2020] UKUT 0147

In the previous edition of *Tax Brief* I looked at cases involving three well-known broadcasters where the principal issue was, in essence, whether they were (quasi) employees or self-employed. This was in the context of IR35 and the use of personal service companies (PSCs). We now have another case, this time involving professional referees. It is a pure "employer:employee" case and does not involve PSCs. The case is *HMRC v. Professional Game Match Officials Limited* ("*PGMOL*") ([2020] UKUT 0147).

It was an appeal from the First-tier Tribunal and the Upper Tribunal considered two fundamental points:-

(a) mutuality of obligation; and

(b) control.

Mutuality of obligation

The Upper Tribunal repeated the words of Langstaff J in the case of *Cotswold Developments Construction Limited v. Williams* ([2006] IRLR 181) where he had said:-

> "Regard must be had to the nature of the obligations mutually entered into to determine whether a contract formed by the exchange of these obligations is one of employment or should be categorised differently."

In other words, whilst mutuality of obligation exists in any contract, the question is as to the nature of the obligations: do they indicate employment or not? This was an important point: specifically, the precise nature of the mutuality of obligations could have a bearing on whether the contract was one of employment or self-employment. At paragraph 49 the Upper Tribunal rejected HMRC's contention that the requirement that there be mutuality of obligation was irrelevant to the categorisation of the contract as one of employment or one of services. On the contrary, it is an essential requirement in categorising a contract as one of employment.

Mutuality of obligation is an important feature of identifying employment or self-employment

So this is helpful.

The Upper Tribunal then considered the minimum requirement in relation to an obligation concerning an employee which was that the employee had to perform at least some work and to do so personally. It would be inconsistent with that obligation if the employee could refuse to work without breaching the contract. Thus the ability to refuse work was consistent with self-employment rather than employment.

Further, the Upper Tribunal stated (within the mutuality of obligation principle) that the minimum requirement of an employer involved an obligation to provide work or, in the alternative, some form of consideration in the absence of work.

The Upper Tribunal then went on (at paragraph 71) to apply the principles enunciated in the law generally and to hold that in the absence of an obligation on PGMOL (the putative employer) to provide at least some work (or some consideration in lieu of work) or in the absence of an obligation on the referee (potential employee) to undertake at least some work there would be an insufficient mutuality of obligation demonstrating an over arching contract in the form of a contract of employment.

So, pausing there the nature of the obligations between the parties is crucial in determining the nature of the engagement: *employment or self-employment*?

The absence of the required obligation on PGMOL (the potential employer) to provide work for the referees or a retainer instead meant that there was an insufficient mutuality of obligation.

That meant that the taxpayer won the case: there was no employment.

Control

The Upper Tribunal then looked at the question of control on the basis presumably that the appeal might then go to the Court of Appeal where the issue of control would fall to be considered again. Since the taxpayer had already won it can be seen therefore that in the context of the Upper Tribunal decision the question of control was purely an academic matter.

The Upper Tribunal considered the test of "a right to step in" within the framework of control. This right involves that the putative employer having a contractual right to direct the manner in which the worker is to perform their obligations and, as part of this right to step in, the employer's directions must be enforceable in the sense that there must be an effective sanction for breach. The right to step in, where it exists, is therefore an indication of control which carries some weight.

> *The "right to step in" is relevant in determining whether control exists*

Pursuant to this, the Upper Tribunal looked at various authorities and, in essence, came to the conclusion that what mattered in determining control was not the practical exercise of day-to-day control and whether actual supervision was possible but "whether ultimate authority over the man in the performance of his work resided in the employer so that he was subject to the latter's order and directions". See *Montgomery v. Johnson Underwood Limited* ([2001] ICR 819) as applied in *Christa Ackroyd Media Limited v. Revenue & Customs Commissioners* ([2019] UKUT 326).

The Upper Tribunal judges came to the conclusion that the process of evaluating the elements of control in question, to see whether they were sufficient to amount to control (indicating employment) *would* need to be undertaken based on the totality of the available evidence. This had not been done by the First Tribunal. Accordingly, the Upper Tribunal held that, since the First-tier Tribunal had not given sufficient weight to this step in test it was possible that the matter should be remitted or else that the Upper Tribunal should undertake the task of applying the appropriate weight themselves. However, given that the Upper Tribunal had already decided the case in favour of the taxpayer the weight to be given to the "step in test" was left unanswered.

Conclusion

The case is a useful one in relation to mutuality of obligation and it gives more help as to how the control test operates.

Speed read

The push back against marketed and aggressive tax avoidance was necessary and justified. It has led, however, to the rule of law being vulnerable in tax matters and a growth of (unwelcome) retrospective legislation

Counsel's opinion - tax and the rule of law – does it even apply now?

All right thinking people understand why steps had to be taken to counter the very aggressive tax avoidance schemes that were widely marketed in the early part of this century. These counter measures involved, of course, the introduction of the DOTAS rules and the GAAR.

However, there was an element of "collateral damage", it seems to me, and these include two intrusions into the rule of law. These are:-

(a) a willingness on behalf of the judges to ignore the plain wording of tax legislation in order to produce a result which the judges think is appropriate; and

(b) a propensity for the government to introduce an increased amount of retrospective legislation.

Repeating that the need to counter tax avoidance is well understood nevertheless it seems to me that we should be careful to protect the rule of law even when that may be difficult.

What is the rule of law?

Back on 20th November 2013 the Bingham Centre for the Rule of Law held a public conference on the subject of "Do our tax systems meet rule of law standards?"

The concept of the "rule of law" is an ancient principle but nevertheless elusive. The Constitution Society have said that the expression is commonly meant to mean that:-

> "Every member of society is bound by and entitled to the benefit of laws which are publicly made and publicly administered and which do not have retrospective effect."

The Constitution Society have also said as follows:-

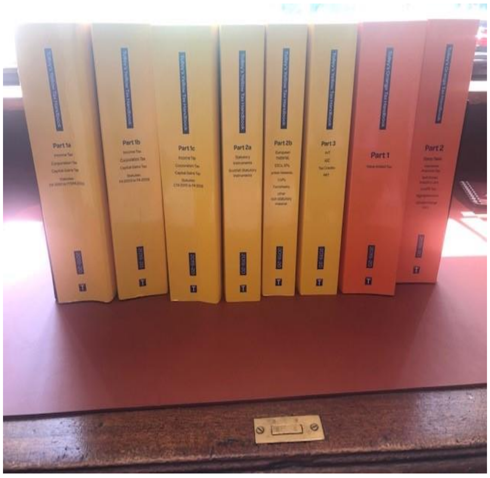
> "The judiciary are often regarded as the guardians of the rule of law, as it falls to an independent and fair judiciary to enforce that rule of law especially when invoked by citizens to protect themselves from the excesses of the state or the executive."

The rule of law does not include retrospective legislation and the judiciary are the guardians of the rule of law

In my opinion we have moved far away from these basic principles in relation to tax; frankly the rule of law does not always apply in relation to tax disputes where tax avoidance is involved.

Tax legislation – despite its length is often ignored

The literal meaning of tax legislation (running to 20,000 pages or more) is often ignored. Often, judges go so far as to say that, in effect, a black letter reading of tax legislation cannot produce the result that it is assumed was intended by Parliament. Accordingly, a literal reading is sidelined; *one might say that the rule of law is sidelined*. This propensity to ignore the literal wording of a tax statute is stated to be by reference to funding the will of Parliament and implementing it; but it is at odds with the way in which the rules of construction should (normally) apply. More particularly, the time-honoured position is that the will of Parliament is found from the legislation itself. Thus, ignoring the legislation is (so it might be said) ignoring the intention of Parliament.



20,000 pages of legislation – often ignored

The intention of Parliament is conveyed by the language of statute

It is interesting to note that in the textbook "Statutory Interpretation" by Francis Bennion (published by Butterworths, 4th Edition) one finds the following at pages 9 and 10:-

> "Statute law is the will of the legislature; and the object of all judicial interpretation of it is to determine what intention is either expressly or by implication conveyed by the language used, so far as necessary for the purposes of determining whether a particular case or state of facts which is presented to the interpreter falls within it."

It is from statute law that the intention of Parliament is ascertained

In addition, of course, the construction of tax law has developed its own over arching rules such as the *Ramsay* principle. This principle, of course, which applies where tax avoidance is concerned, allows steps undertaken in a transaction to be notionally recast so that a "realistic view" of events can be found. In other words, a notional situation "trumps" the actual situation.

Ignoring Parliament's intentions [as stated in statute] can lead to dangerous and unpredictable results

In relation to this point, it is worth remembering the words of Lord Hoffmann in "Tax Avoidance [2005] BTR 197:-

> "... tax avoidance in the sense of transactions successfully structured to avoid a tax which Parliament intended to impose should be a contradiction in terms. The only way in which Parliament can express an intention to impose a tax is by statute that means such a tax is to be imposed. If that is what Parliament means, the courts should be trusted

> to give effect to its intentions. Any other approach will lead us into dangerous and unpredictable territory."

> *The courts should give effect to statute – otherwise the outcome will be "dangerous and unpredictable" – Lord Hoffmann*

In my view we have reached that stage (unpredictable territory) except that we are in what I would call entirely *predictable* territory. I say this because where tax avoidance is concerned the position is that whatever the law may say HMRC will almost certainly win a tax avoidance case. There are exceptions to this but they are few and far between.

I repeat that this has arisen because of the aggressive schemes that have been launched which would have plundered many billions of pounds from the Exchequer but nevertheless I just sound a word of caution: the rule of law is worth preserving.

Propensity for retrospective legislation

To add to this, as mentioned, we have a propensity for retrospective legislation and by this I include legislation which is retroactive. On this front I refer again to the Constitution Society's definition of the rule of law above: it does "not have retrospective effect").

In relation to retrospective legislation we have seen recently initial draft legislation in relation to the loan charge which sought to backdate ITEPA 2003 Part 7A (disguised remuneration) to a starting point more than ten years before Part 7A was introduced – thankfully following the Morse Report this has been corrected; we have seen retrospection in relation to entrepreneurs' relief where steps that were taken before the December Budget were subsequently ruled out; and we have seen the effect of the *Inverclyde* decision overturned by legislation. Indeed, the Budget notes, in respect to the *Inverclyde* decision include the following:-

> "The Government will legislate prospectively and retrospectively in Finance Bill 2020 to put beyond doubt that LLPs will be treated as general partnerships under income tax rules."

I repeat that the "new" stance in relation to construction of legislation and the imposition of retrospective legislation is understandable but it is surely time that the rule of law was more readily a part of the world of tax law construction. Alternatively, a decision could be made that the rule of law has no application to tax avoidance – I suspect most of consider that is the case anyway.

CURMUDGEON'S CORNER

Wearing my Victor Meldrew hat my current "beef" is the misuse of the word "alternate" when the word "alternative" is meant instead.

To alternate is to take turns; an "alternative" is an option. One can test this by looking at the recent release from the Tribunal in relation to "alternative dispute resolution". Perish the day when this becomes "alternate dispute resolution".

AND FINALLY

BEYOND REASONABLE DOUBT

It has been reported that judges have been asked to stop using the expression "beyond reasonable doubt" because jurors do not understand what it means. Instead, they are being asked if they are "satisfied that they are sure".

In the tax context, the standard of proof is "on the balance of probabilities" except on those rare occasions where "beyond reasonable doubt" is used – this would be the case where tax fraud was alleged.

I have to say that I was pleased to see that the expression "beyond reasonable doubt" was considered not to be sufficiently clear. I never thought it was.

To some extent my doubts about its meaning have been supported by some excellent correspondence in The Times. One correspondent said:-

> "As a student studying criminal law I first came across the definition of reasonable doubt as being "such doubt as may reasonably be doubted by twelve reasonably doubtful men""

Another correspondent told of a story involving the late Lord Denning who had tried a jury case in Oxford where the jury was composed entirely of dons. They had asked a lot of (not always helpful) questions including if Lord Denning could help with clarification of the evidence.

When the dons had not returned from considering the evidence after a long time Lord Denning sent for them and their foreman reported that they had encountered a problem which the judge's offer of clarification of the evidence or the law could not help them to resolve.

Lord Denning then asked if the foreman could at least explain the nature of the difficulty to which he said

> "Well it's this", the foreman replied, "we are all agreed that there is doubt but we can't agree whether it's reasonable."

I rest my case.

PATRICK WAY QC

THANK YOU

Thank you for Stephanie Talbot for producing Tax Brief – it looks very professional IMHO. Also thank you to Kenneth Richardson (kenneth@kennethrichardson.co.uk) for the overall design.