Field Court Tax Chambers

FCTC Digest

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EDITORIAL

Imran S Afzal

Welcome to the seventh edition of the *FCTC Digest*. There is some very valuable material here from leaders in their fields.

There are numerous provisions which seek to apply the employment tax provisions in circumstances where individuals provide services to clients through intermediate companies and agencies. For a discussion of recent changes to the "OPW" provisions please read **Patrick Soares'** article *The New Off-Payroll Working (OPW) Provisions Effective From 6 April 2021*.

The idea of a "double tax charge" is anathema to many tax practitioners, and so the Upper Tribunal's recent decision in the *Candy* case is of particular interest because of the double SDLT charge that arose. Please read **Patrick Way QC's** article *The Candy SDLT Case* for a detailed discussion.

The concept of domicile is one of the bedrocks of tax law, and although the law is well-established it is never a bad idea to have a refresher. For an overview of the general principles, and a discussion of recent cases, **Philip Baker QC's** article *Recent Domicile Cases And Developments* is a must read. In particular, don't miss the interesting discussion of procedural issues in the latter part of the article.

If you have ever thought that it is difficult for taxpayers to succeed in tax litigation, then **Peter Vaines'** article *The Supreme Court Riding To The Rescue* may give you hope! Peter discusses three cases which, to use his words, *"highlight the possibility (or perhaps hope) that the Supreme Court is adopting a more sympathetic approach to the taxpayer than has been apparent in the past*."

Katherine Bullock's article *The Residential Property Developer Tax – Birth Of A Super Tax?* is a must read for property developers. In addition, however, it is of more general interest in light of Katherine's view that the Residential Property Developer Tax is *"a possible template for future taxes."*

Finally, for a discussion of equity releases, hedge accounting, the *Manchester Building Society* case, and counter-factualism, do not miss **David**

Southern QC's article *Equity Release, The SAAMCO Cap And Counter-Factualism*.

Happy reading!

THE NEW OFF-PAYROLL WORKING (OPW) PROVISIONS EFFECTIVE FROM 6 APRIL 2021

Patrick C Soares

INTRODUCTION

There are a great many provisions which seek to apply the PAYE and employment provisions to situations where an individual (the consultant) provides services to a client in the UK through intermediate service companies and agencies.

The income tax provisions are in ITEPA 2003 Part 2:

(1) Chapters 7 (Agency Workers),

(2) Chapter 8 (Intermediaries),

(3) Chapter 9 (Managed Service Companies) and

(4) Chapter 10 (OPWs).

These provisions have not had a good success rate (from HMRC's viewpoint) and they have been extended and amended in the Finance Act 2020 and the Finance Act 2021.

EXTENSION OF THE OPW CODE FROM 6/4/21

The OPW provisions originally only applied to public sector clients.

That code from 6/4/21 has been extended to all medium sized and large clients and it is no longer restricted to the public sector.

A corporate entity will be medium or large-sized if it meets at least two of the following criteria for two consecutive financial years:

- turnover of more than £10.2 million
- a balance sheet total (assets) of more than £5.1 million
- an average of more than 50 employees

The key OPW provisions are in ITEPA ss61M and 61N.

AMBIT OF THE OPW CODE

Section 61M sets out the ambit of the OPW code thus:-

> **“61M Engagements to which Chapter applies”**
>
> (1) [The OPW code will] apply where—
>
> (a) an individual (“the worker”) **personally performs**, ...services for another person (“the client”),
>
> (b)....
>
> (c) the services are provided not under a contract directly between the client and the worker but under **arrangements involving a third party** (“the intermediary”),
>
> (ca) **the client.................**(ii) is a person who qualifies as medium or large and has a UK connection..... and
>
> (d) the circumstances are such that—
>
> (i) if the services were provided under a contract directly

between the client and the worker, **the worker would be regarded for income tax purposes as an employee of the client** or the holder of an office under the client, or

(ii) ....

<u>JOINING THE CHAIN GANG – ISSUING STATUS DETERMINATION STATEMENTS AND FINDING THE FEE-PAYER</u>

Section 61N contains what may be called the "chain provisions."

If the client pays an agency which in turn pays the client's personal service company (PSC) then the top person in the chain is the client and the lowest person is the PSC (called "the intermediary:" see ITEPA 2003 s61O as amended by FA 2021 s21). The consultant cannot form part of the chain.

The person who applies PAYE and employment NIC is called the fee-payer and this is the person in the chain who is UK resident or has a place of business in the UK who is immediately above the lowest person in the chain. Thus in the above example if the agency is resident in the UK it is the fee-payer as it is immediately above the PSC.

The client, however, is better placed than say the agency to make a judgement of whether the consultant is providing services in the nature of employment services. The legislation accordingly requires the client to provide the consultant with a status determination statement (SDS) confirming that employment status and HMRC take the view it must also be provided to the agency. If the client does not provide such a statement the client must apply the PAYE provisions and the NIC employment provisions and the client becomes the fee-payer (ITEPA 2003 s61N(5)).

HMRC in ESM 10017 give the following example:

> **EXAMPLE ONE**
>
> End-Zone Ltd, a medium/large-sized client, contracts with Field Goal Ltd, a recruitment agency, to provide the services of a worker (Jane) who operates through her own PSC (Jane Ltd) and is paid by Field Goal Ltd on a

monthly basis upon production of an invoice. Field Goal Ltd has a place of business in the UK. End-Zone Ltd is the client. Field Goal Ltd is the fee-payer.

The role which Jane will fill is judged to be caught by the off-payroll working legislation by End Zone Ltd. End-Zone Ltd should give a Status Determination Statement to Jane and Field Goal Ltd. Field Goal Ltd is responsible for deducting tax and NICs from the payments and paying these to HMRC.

If the agency in the above example is not resident in the UK and does not have a place in the UK from which it carries on its business (it is thus not a "qualifying person") then it drops out of the chain and client must apply the PAYE code and the employment NIC provisions: this is because the client is the next one above the lowest person in the chain (the PSC is the lowest person in the chain) if the foreign agency falls out of the chain. HMRC in ESM10017 confirm the position thus:

> "….. if there is no person in the chain below the client and above the worker's

> intermediary who is a qualifying person, then the client is the deemed employer and responsible for the deduction of tax and NICs”

THE EQUIVALENT NIC PROVISIONS

The equivalent NIC provisions are in The Social Security Contributions (Intermediaries) Regs 2000/727 regs 13 and 14.

TARGETED ANTI-AVOIDANCE PROVISION

There is a targeted anti-avoidance provision in ITEPA 2003 s61WA. This is designed to counter arrangements structured to ensure a taxpayer does not have an intermediary for relevant purposes.

WHAT THIS MEANS FOR MEDUIM AND LARGE COMPANIES

Nothing can be gained by having a non-resident company in the chain. That company is ignored in the chain as it is not a qualifying company and all it means is HMRC will look for other persons in the chain, usually the client, to apply PAYE and employment NIC.

Medium and large companies will need to review their positions (if they are the clients) – they may need to issue status determination statements and may end up being the fee-payer having to apply PAYE and employment NIC.

THE *CANDY* SDLT CASE

Patrick Way QC

Introduction

The recent Upper Tribunal decision in the case of *HMRC v. Christian Candy* ([2021] UKUT 170 (TCC) has attracted much publicity in the national press. This is because Stamp Duty Land Tax ("SDLT") was paid twice effectively in respect of the same instrument relating to the purchase of Gordon House, Chelsea.

SDLT was paid, first, by Christian Candy in relation to an agreement (the "Relevant Agreement") for the assignment of a so-called "contracted-out lease" over Gordon House.

Secondly, SDLT was paid when all of Christian Candy's interests in Gordon House were gifted to his brother, Nick Candy, who was obliged to pay SDLT again.

The mechanics of transferring the property interests to Nick Candy were complicated but they involved a deed of novation by which Christian Candy was released and discharged from any future obligations and liabilities in respect of the Relevant Agreement and Nick Candy took those over.

"Double tax" – if that is what it was and Christian Candy argued that it was just that – could be reduced to one single tranche of tax provided that Christian Candy was entitled to a repayment of the SDLT which he had incurred in relation his acquisition of the Relevant Agreement.

The question for the tribunals was whether Christian Candy was indeed entitled to repayment of the SDLT which he had incurred when he acquired the Relevant Agreement.

The Finance Act 2003 ("FA 2003") s.44(9) allows repayment of SDLT (such as that paid by Christian Candy) where a contract (which has been substantially performed – as was the case here) is afterwards rescinded or annulled or is for any other reason not carried into effect. To obtain a repayment there has to be an amendment to the land transaction return.

However, FA 2003 Schedule 10 paragraph 6 states that:-

> "except as otherwise provided an amendment may not be made more than twelve months after the filing date."

Christian Candy made the amendment to the land transaction return <u>more than</u> twelve months after the filing date. Nevertheless, he argued that the limitation period mentioned in Schedule 10, paragraph 6 did not apply to his situation.

The case, therefore, turned upon whether the twelve-month limitation period did apply to a situation falling within s.44(9) or not.

Christian Candy had been successful before the First-tier Tribunal but, as this article describes, HMRC won their appeal in the Upper Tribunal: Christian Candy was out of time to obtain repayment of SDLT in respect of the substantial performance of the Relevant Agreement.

<u>Relevance of the case</u>

The facts of the case are relatively complicated. Nevertheless it seems to me, that three main issue arise.

The first issue (subject to any further appeal) is that in respect of the substantially performed provisions within the SDLT legislation (FA 2003 s.44) there is a limited time to obtain repayment of tax where a contract is rescinded or annulled, or for any other reason, not carried through. The statutory time limit applies.

Secondly, the case demonstrates again the difficulties of litigation since many of the points which found favour at first instance failed to do so on appeal.

Thirdly, the Upper Tribunal decision seems to have been based, at least to some extent on the fact that the steps (at least in the eyes of the Upper Tribunal) involved an element of avoidance. The implication may be that had there been no such avoidance the Upper Tribunal might have come to a different view and therefore a different analysis of the wording of s.44(9). In my view, however, the relevant statutory wording under review involves no element of motive and therefore the decision should not have been affected (if it was) by any involvement of avoidance.

For what it is worth I can see that there was an element of avoidance. I say this because the deed of novation did not simply annul or rescind the Relevant Agreement; it also in effect assigned the

Relevant Agreement to Nick Candy and it sought to do that in a way that would enable the first tranche of SDLT to be repaid when otherwise it would not have been so possible. For example, had there simply been a subsale of the Relevant Agreement in favour of Nick Candy that would not have enabled a claim for a repayment of the first tranche of SDLT.

<u>The facts</u>

The property in question, as mentioned, is Gordon House which is a substantial property adjacent to the grounds of the Royal Hospital in Chelsea, London.

On 9th August 2012 Christian Candy entered into two contracts. The first was an agreement for a lease (the initial lease) for a term of 25 years and it was entered into together with a supplementary deed which governed the development of that property by Christian Candy. The premium for the grant of the initial lease was £20m.

The second agreement was an agreement (the "Relevant Agreement" – as already defined) for the assignment to Christian Candy of another lease (the "contracted out lease") for a term of 201 years from 1st October 2012. The purchase price for the contracted out lease was £48m. payable in four instalments. Christian Candy paid the first instalment of £7.3m. on the 1st October 2013.

The SDLT dispute was exclusively in respect of the SDLT regarding the agreement (the Relevant Agreement) for the contracted out lease which had been cancelled: *did that cancellation allow Christian Candy to recover his SDLT, or was he out of time*?

The initial lease was granted on the 1st October 2012 and the contracted out lease was granted on the 16th April 2019.

There were very specific reasons for entering into the agreements as described and they were particularly in order to ensure that the contracted out lease fell outside the enfranchisement legislation which applies to long leases of residential properties and gives tenants the right to the extension of lease terms and in certain cases the right to acquire the relevant freehold.

As mentioned, Christian Candy entered into the agreements on the 9th August 2012 and on the next day his building contractors began work at Gordon House thereby effecting substantial performance of the Relevant Agreement for the contracted out lease (as the parties agreed) pursuant to FA 2003 s.44(4) which states:

> "(4) If the contract is substantially performed without having been completed, the contract is treated as if it were itself the transaction provided for in the contract."

In other words, where "substantial performance" occurs the effect is the same for SDLT purposes as if (legal) completion had taken effect.

Nearly two years later Christian Candy then gifted his interests in Gordon House (being the initial lease and the agreements relating to the contracted out lease including, in particular, the Relevant Agreement) to his brother, Nick Candy. As a result, the initial lease was assigned to Nick Candy and the supplemental deed and the contracted out lease agreement (the Relevant Agreement) were novated in favour of Nick Candy by a formal deed of novation.

Immediately upon execution of the deed of novation Nick Candy took possession of Gordon House and paid the second and third tranches of the £48m.

premium on the 1st October 2014 and then on the 1st October 2015.

Christian Candy had paid SDLT in respect of both the completion of the initial lease (which was not the subject of any appeal) and the substantial performance of the Relevant Agreement.

Nick Candy, on taking possession of Gordon House, substantially performed the novated agreement himself (the Relevant Agreement) for the contracted out lease himself for the purposes of s.44(4) and in these circumstances the chargeable consideration paid by him was deemed to be the full price received by the seller of £48m. rather than the three outstanding instalments. This was as a result of the subject matter of the deed of novation being an uncompleted contract and the gift being between relatives so that the special charging provision within Schedule 2A, paragraphs 12 and 14 were engaged.

The issue

Now at last we come to the key point. This is that on the 10th April 2014 Christian Candy applied for repayment of the amount of SDLT that he had paid on substantial performance of the Relevant

Agreement. The SDLT at stake was £1,920,000 and he sought repayment by amending the SDLT return pursuant to the provisions of FA 2003 s.44(9).

This reads as follows:-

> "(9) Where subsection (4) applies [contract substantially performed – as was the case here] and the contract is (to any extent) afterwards rescinded or annulled, or is for any other reason not carried into effect, the tax paid by virtue of that subsection shall (to that extent) be repaid by the Inland Revenue.
>
> Repayment must be claimed by amendment of the land transaction made in respect of the contract."

The sixty-four thousand dollar question was whether the time limit provisions found within FA 2003 Schedule 10, paragraph 6 applied to prevent Christian Candy being able to amend the land transaction return which he had made when he became entitled to an agreement (the Relevant Agreement) for the assignment of the contracted out lease back on 12th August 2012.

Paragraph 6 reads as follows:-

> "*Amendment of return by purchaser*"
>
> 6-(1) The purchaser may amend a land transaction return given by him by notice to the Inland Revenue.
>
> ...
>
> (3) Except as otherwise provided, an amendment may not be made more than twelve months after the filing date."

The definition of "filing date" is found at FA 2003 Schedule 10 paragraph 2 and the filing date in relation to a land transaction return is the last day of the period within which the return must be delivered.

By virtue of FA 2003 s.76 the purchaser must deliver a return to the Inland Revenue before the end of the period of fourteen days after the effective date of the transaction and pursuant to FA 2003 s.119 the effective date is the date of completion or such other alternative date as HMRC may prescribe and, as has been seen, pursuant to FA 2003 s.44(4) the meaning of "effective date" can be when a contract is substantially performed without having been completed.

In the circumstances, where possession had been taken by Christian Candy on the 10th August 2012 (the effective date) and the land transaction return was sought to be amended on the 10th April 2014 it can be seen that that was clearly more than twelve months after the filing date.

The question in a nutshell

The question in a nutshell is whether s.44(9) is subject to the time limits mentioned in Schedule 10, paragraph 6.

Not surprisingly, HMRC argued that those time limits applied and, equally not surprisingly, Christian Candy argued that they did not.

As is often the case with litigation (even where millions of pounds are at stake) the answer turned on the meaning of one word. In this case that word was “afterwards”.

So, in s.44(9) when it states that the contract is “*afterwards* rescinded or annulled” does the use of the word “afterwards” bring the situation within the exception mentioned within Schedule 10, paragraph 6(3)?:-

> "(3) Except as otherwise provided an amendment may not be made more than twelve months after the filing date."

That is the question which the Tribunals had to consider.

The argument for Christian Candy, in essence, was that because the draftsperson had used the word "afterwards" in s.44(9) that effectively meant "*any* time afterwards" and must therefore indicate that s.44(9) was an exception to the 12-month rule.

Whilst the First-tier Tribunal agreed with this argument the Upper Tribunal did not.

The different views of the two Tribunals

The two tribunals (the First-tier Tribunal and the Upper Tribunal) came to different conclusions. The First-tier Tribunal decided that there was, in effect, no time limit on making an amendment in these circumstances because the word "afterwards" was indeed an exception to the twelve-month provision stated in Schedule 10, paragraph 6. It was "temporal" that is to say the word "afterwards" was making it plain that repayment of SDLT could be obtained at any time afterwards. By contrast the Upper Tribunal held that there was no such exception and the twelve months' time limit stood.

The word "afterwards" was not temporal; it was stylistic.

The following chart sets out the key points that were considered by the two Tribunals and the different decisions to which they came.

Subject	**First-tier Tribunal**	**Upper Tribunal**
Meaning of "except as otherwise provided"	Para.68 - It was held that at the time that the Finance Act 2003 was enacted there were no other provisions to which "except as otherwise provided" could refer other than s.44(9). On that basis, it must be the case that s.44(9) was one of the exceptions.	Paras.86(3) and 87 - "Except as otherwise provided" does not have a particular bearing on the correct legal result and the words may simply have been included because they might be useful in the future. The FTT were wrong in assuming that the words had to refer to another particular provision.
"Afterwards"	Para.75 - "Afterwards" is used in temporal sense and must have been intended to add to the meaning of the provision [i.e., at any	Para.87 - No weight should be attached to "afterwards".

	time following the rescission or annulment etc]	
Fairness	Para.77 - By construing the word "afterwards" to be effective to override the time limits this was a fair outcome not least because it avoids economic double taxation	Para.109 - In effect, there is no double taxation because the tax is in respect of two different persons by reference to two different periods which is a natural incident of the system.
Hierarchy	Para.82 - The taxpayer argued that the fact that the time limit rules were found in the Schedule meant that they had lesser status than being in the main body of the legislation. In fact the FTT itself found that this argument was not persuasive.	The point was not argued again.
Explanatory notes	Para.83 - Doubtful that explanatory notes to the Finance Bill 2003 could be an aid to construction and even if they could they did not take the discussions much further	Para.32 - Reference was made to the case of *R (Westminster City Council) v. National Asylum Support Service* [2002] 1 WLR 2956 where Lord Steyn had held at [5] that a court could consider explanatory notes as an admissible aid to construction in so far

		as they cast "light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed." Therefore, these explanatory notes are relevant.
Smallman v. HMRC [2018] UKFTT 0680 (TC) Whether this case was relevant in determining whether a time limit applied as discussed Held: the attempt to amend the return was out of time	Para.84 - Decision in *Smallman* is not binding and does not address the possibility in any event that s.429 does "otherwise provide" time limits. On that basis it made per incuriam	Not argued in the Upper Tribunal
Purpose	Para.49 - The right to repayment is widely worded and reflects the underlying mischief which s.44 was enacted to address. If the underlying contract is deemed to be performed but in fact is not actually	Para.67 - Section 44(9) would be satisfactory (and this therefore indicates its purpose) if the result of a rescission etc., was that each contracting party was returned so far as possible to the position that it had

	performed as a matter of law then the mischief behind s.44 disappears. In these circumstances there would be a an unfairness if there could be no repayment of tax where the contract was not ultimately performed as a matter of law and the repayment mechanism should safeguard this. Para.43 and 77 - The FTT's decision ameliorates the broad charging effect of s.44 and provides the taxpayer with the right to repayment in circumstances where a contract which is substantially performed is not substantially carried into effect – particularly where the rescission of the contract occurs more than one year after the filing date.	been in prior to the contracts being entered into. On that basis it can be seen why SDLT payable on substantial performance of the contract should be repaid to the purchaser but that is not the case here.

I do not know whether permission to appeal to the Court of Appeal will be obtained but it seems that it ought to be, given the amounts at stake and the fact that the two decisions have come up with contradictory views.

Christian Candy is in very good hands but the difficulty he faces, in my view, is simply that s.44(9) is short and to the point and does not appear (to my eyes at least) to override the time limits set out in Schedule 10, paragraph 6.

The word "afterwards" just seems to me to be nothing more than stylistic. The rescission of a contract could hardly occur *before* the date of the contract, after all, and this is why I consider that the word "afterwards" is not of a "temporal" nature as was argued by Christian Candy and upheld by the First-tier Tribunal but not the Upper Tribunal.

Undoubtedly, however, this case demonstrates the difficulty with tax litigation. Here, by reference to precisely the same arguments are two entirely different outcomes.

Relevance of avoidance

One of the "bugbears" which I have with this case and other cases is that in construing important words there is a tendency to let the relevance of avoidance (as they see it) "intrude" upon their analysis of the meaning of the words.

This seems to me to be evident in this particular case.

I refer to the following paragraphs from the Upper Tribunal decision:-

> "63. When it was enacted in 2003, section 44 contained, however, at least three possible avenues to avoidance each of which was removed by FA 2004."

In paragraph 67 is found the following:-

> "67. … neither expression [rescission or annulment] is defined but they would, in our view, be apt to cover a case where the contract is put to an end with each contracting party being returned (so far as possible) to the position they were in before the contract was entered into. In such a case it is easy enough to see why the SDLT payable on substantial performance of the contract should be repaid to the purchaser."

The “beef” I have with this particular paragraph is that whilst the Upper Tribunal have said (see paragraph 67 mentioned above) they could see circumstances where s.44(9) could operate appropriately nevertheless they do not address the fact that even in such an “acceptable” situation there would be a strict statutory time limit. In other words, why should a (pure) rescission or annulment be subject to a time limit?

We then find at paragraph 115 the following:-

> “... an avoidance charge that could be unwound without any time-limit could be open to abuse.”

And then again at paragraph 116 we see the following:-

> “116. We also note that avoidance concerns continued to dog the SDLT regime until the enactment in 2006 of the new section 75A.”

In other words, avoidance seems to have been at least somewhere within the minds of the Upper Tribunal judges. The perception therefore is that had there been no avoidance or no perceived avoidance the Upper Tribunal might have come to a different conclusion. Given however that there is no motive test within the legislation under review that is unsatisfactory, assuming it is a justified view of mine.

However, from my point of view, I can understand why it was considered (if it was) that there was, after all, an element of avoidance. This is because Christian Candy had use of the property for a period of time. He would not have been able to transfer on the property by way of a straightforward gift to his brother (and recover his own SDLT) except by entering into some form of rescission or annulment. However, in the situation under review the deed of novation did not simply rescind or annul the original agreement it went one step further and assigned the Relevant Agreement to Nick Candy.

Also, in my view (accepting that the matter will probably be appealed to the Court of Appeal) it seems plain to me that s.44(9) is subject to the time limits described in Schedule 10 paragraph 6. The word “afterwards” in s.44(9) does not seem to me to take the situation outside the statutory time limits mentioned in Schedule 10 paragraph 6.

As already mentioned Christian Candy, however, is in very good hands and he may well be successful on any such appeal, despite my concerns.

Alternative appeal

As it happens, there is an alternative appeal which has been stayed. That separate issue, as I understand it, concerns Christian Candy's claim for overpayment relief pursuant to Schedule 10, paragraph 34(1) where there is a four-year time limit. In respect of that claim HMRC did open an enquiry and a closure notice was then issued on the 13th August 2015 which is the subject of a separate appeal (TC/2015/6378).

Practical issues

If the decision relating to the wording of s.44(9) stands it means that SDLT paid on substantial performance in circumstances where the contract is not completed but is instead rescinded or annulled can only be recovered if the strict time rules are adhered to.

That seems hard because there will be situations from time to time where there will be substantial performance of a contract but where also the parties are not able to reach completion. In these circumstances (using the words of the Upper Tribunal referred to above) each contracting party should be able to be returned so far as possible to the position they were in before the contract had been entered into without having to pay SDLT for what is, in effect, a "non-event".

The current decision means that, in those circumstances, the relevant party might be out of time and therefore, in such a situation, HMRC would receive SDLT for "nothing".

Given that the Upper Tribunal found (at para.67) that there were circumstances where it was easy enough to see why SDLT (payable on substantial performance) should be repaid to the purchaser it is hard to see why there should be any time limit where all that is happening in a straightforward situation is that the parties are being put back to their pre-contract position and are effectively "walking away" from the land transaction.

The difficulty, however, as already mentioned, is in the situation under review, concerning the Candy brothers, there was not what one might call a plain vanilla rescission or annulment putting the parties back in the position to which they were before entering into the original contracts. As already mentioned, the deed of novation brought the Relevant Agreement to an end so far as Christian Candy was concerned but in effect it arranged for that Relevant Agreement to be transferred to Nick Candy. On that basis it could be said that the deed of annulment was "not doing the work" of a pure rescission or annulment. Nevertheless this observation of mine should be an irrelevance in the *Candy* case because the question is simply one of construction of s.44(9) and the prevailing circumstances should not affect this black letter interpretation.

Conclusion

The current decision means that purchasers will need to be wary where there is substantial performance and a risk of rescission or annulment occurring outside the twelve-month window as they will suffer irrecoverable SDLT even though they have no land interest to show for that SDLT following the extinction of the transaction.

RECENT DOMICILE CASES AND DEVELOPMENTS[1]

Philip Baker QC

This subject has been broken down into three topics, though I will spend more time on the first two. I thought I would look back and see what cases relating to domicile have come out in the last couple of years. I have divided them between what I have called cases on substantive law – that is essentially cases deciding whether or not a particular person is or was domiciled in the UK or abroad, so recent decisions about domicile – and some very interesting recent cases on tax procedure in relation to domicile issues. I will also say something about domicile enquiries.

<u>Cases on substantive law</u>

The law in this area is very well established. One of the interesting things is that, if you look at the last couple of years' cases, they have all quoted from standard statements of the rules on domicile. *Dicey Morris & Collins* is the leading text on conflict of

[1] This is based on the text of a talk given to the STEP, City of London branch in June 2021.

laws, and they quote Dicey Rules 10, 11 onwards. None of the recent cases have sought to challenge the existing case law or really to amend it. I cannot point to any recent cases that have taken the law forward or in a different direction.

To start by flagging up a couple of not-desperately-recent cases, but ones that contain very clear statements about the rules on domicile. There's a case from 2006 called *Agulian v Cyganik*[2] where the Court of Appeal summarises the rules on domicile. There is a rather interesting little quotation (at para [46]):

> "Positioned at the date of death in February 2003 the court must look back at the whole of the deceased's life, at what he had done with his life, at what life had done to him and at what were his inferred intentions in order to decide whether he had acquired a domicile of choice in England by the date of his death. Soren Kierkegaard's aphorism that "Life must be lived forwards, but can only be

[2] [2006] EWCA Civ 129

> understood backwards" resonates in the biographical data of domicile disputes."

That is a lovely quotation from Kierkegaard. It is very true, and we are all well aware of the process by which we sit down with the client and ask, "where were you born?", "were your parents married?" – always a bit embarrassing – "where was your father settled at the time", and then work through peoples' lives to determine their domicile.

The other Court of Appeal case where Lady Justice Arden, now Lady Arden, sets out a very clear statement of the rules on domicile is the *Barlow Clowes International Ltd v Peter Henwood* case.[3] I have taken from that case the summary by Lady Arden of the rules on domicile (at paras [8] to [21]:

> 8. The following principles of law, which are derived from Dicey, Morris and Collins on *The Conflict of Laws* (2006) are not in issue:
> (i) A person is, in general, domiciled in the country in which he is considered by English law to have his permanent home. A person may sometimes be domiciled in a country although he does not have his permanent home in it (Dicey, pages 122 to126).

[3] [2008] EWCA Civ 577.

(ii) No person can be without a domicile (Dicey, page 126).
(iii) No person can at the same time for the same purpose have more than one domicile (Dicey, pages 126 to128).
(iv) An existing domicile is presumed to continue until it is proved that a new domicile has been acquired (Dicey, pages 128 to 129).
(v) Every person receives at birth a domicile of origin (Dicey, pages 130 to 133).
(vi) Every independent person can acquire a domicile of choice by the combination of residence and an intention of permanent or indefinite residence, but not otherwise (Dicey, pages 133 to138).
(vii) Any circumstance that is evidence of a person's residence, or of his intention to reside permanently or indefinitely in a country, must be considered in determining whether he has acquired a domicile of choice (Dicey, pages 138 to143).
(viii) In determining whether a person intends to reside permanently or indefinitely, the court may have regard to the motive for which residence was taken up, the fact that residence was not freely chosen, and the fact that residence was precarious (Dicey, pages 144 to151).
(ix) A person abandons a domicile of choice in a country by ceasing to reside there and by ceasing to intend to reside there permanently, or indefinitely, and not otherwise (Dicey, pages 151 to153).

(x) When a domicile of choice is abandoned, a new domicile of choice may be acquired, but, if it is not acquired, the domicile of origin revives (Dicey, pages 151 to 153)

The intention required for a domicile of choice ((vi) above)

10. The **intention of residence must be fixed and must be for the indefinite future**. It is not enough for instance that at any given point in time its length has not been determined.

14. Given that a person can only have one domicile at any one time for the same purpose, he must in my judgment have **a singular and distinctive relationship with the country of supposed domicile of choice**. That means it must be his ultimate home or, as it has been put, the place where he would wish to spend his last days. Thus, in *Bell v Kennedy* (1868) LR 1 Sc and Div 307, 311, Lord Cairns, having held that it was unnecessary for him to examine the various definitions that have been given of the term "domicile", held that the question to be considered was in substance whether the appellant:

> "had determined to make, and had made, Scotland his home, with the intention of establishing himself and his family there, *and ending his days in that country*?" (emphasis added)

15. In my judgment this test by its reference to **ending one's days** usefully emphasises the

need for the subject to have a fixed purpose that he will live in the country of his domicile of choice.

18. **A person can acquire a domicile of choice without naturalisation**. (Dicey, page 136.). On the other hand, **citizenship is not decisive**: *Wahl v Wahl* [1932] 147 LT 382. An intention to be buried in a particular place has in some circumstances been treated as an important factor, but in other cases discounted (Dicey, page 140).

19. Frequently the subject of a dispute as to domicile (often called "the propositus") will make statements or declarations as to what he intends. But **the court should not rely on these statements unless corroborated by action consistent with the declaration**.

Lady Arden's statements are particularly clear. On the intention required for the acquisition of a domicile of choice (and none of this is new) she emphasised the intention must be to reside, the intention of residence must be fixed and must be for the indefinite future. So to acquire a domicile of choice you have to reside in a country with the intention of residing there indefinitely or permanently, and she puts that a little later on as a singular and distinctive relationship with the country of supposed domicile of choice. At the end of the day the Court of Appeal concluded that Peter Henwood did not have a singular and distinctive relationship with Mauritius.

The case goes on also to quote from *Bell v Kennedy*[4] that the propositus “had determined to make, and had made, Scotland his home, with the intention of establishing himself and his family there, *and ending his days in that country*".

Lady Justice Arden picks that up, and flowing through a number of the cases is the question: where did the individual propose to end his or her days? That was where they intended to permanently reside.

Finally, Lady Justice Arden notes from Dicey that a person can acquire a domicile of choice without naturalisation. On the other hand, citizenship is not decisive[5]. There is some debate at the moment about the relevance of seeking naturalisation in the UK as an indicator of adopting a domicile of choice here. It is clear that citizenship and domicile are not the same thing, and that it is, in principle, perfectly possible to

[4] (1868) LR 1 Sc and Div 307, 311.
[5] See Wahl v Wahl

become naturalised in the UK without acquiring a domicile of choice here.

With that reminder of what the rules are, let me go into some cases over the last couple of years.

Holliday v Musa[6] is an application under the Inheritance (Provisions for Family and Dependants) Act. In order for such a claim to be made, the deceased must have been domiciled in the UK. This was a claim by the deceased's informal partner and her children.

The deceased was a Mr Guney and he had died in the UK but his origin was in Cyprus. He was a Turkish Cypriot. He lived in the UK for almost 50 years prior to his death. He came in the late 50's when there was already inter-religious violence in Cyprus that led him to leave, and he remained in the UK until his death. He retained very strong links with Cyprus and what became the Turkish part of Northern Cyprus. At one time he was planning to stand to become President of Northern Cyprus. He filled out a *Dom 1* form for the Revenue and in that he claimed his domicile was in Northern Cyprus (though the Court

[6] [2010] EWCA Civ 335.

of Appeal treated that statement with caution, linked up to the point made earlier that statements are only to be relied upon if they are consistent with the individual's actions).

So far as actions were concerned, Mr Guney frequently stated his intention to retire to live in Cyprus but, though he was in his 70's when he died, he never implemented that intention. He never in a sense retired, and never actually went back to live in Cyprus. He had acquired various properties in the UK and the case has a long list of the different UK properties. He also had a burial plot in the UK and also a mausoleum in Cyprus. Putting all of that together the Court of Appeal concluded that Mr Guney had in the latter part of his life made up his mind that his permanent home was, in fact, in England and that was where he wished to end his days, and that he planned to be buried in the UK. So, despite his statements and strong social links with Cyprus, that was not reflected by his conduct.

Next case is *Ray v Sekhri*.[7] This was a divorce case – the wife petitioning for divorce in the UK, and one of the grounds for jurisdiction is that one or both of the parties is domiciled in the UK. The husband denied that either of them was domiciled in the UK, so, as preliminary matter, the Family Court had to determine whether one or both of them was domiciled in the UK. The Court concluded that both were at the end of the day domiciled here.

The husband had been born in the UK but he was born to a family of Indian origin and the evidence was that his father never really intended to settle in the UK. So, the husband may or may not have had an Indian domicile of origin. He was an international lawyer, an arbitration specialist, working for a US law firm, and they moved him to Singapore. At the time of the divorce he and his wife were living in Singapore.

The wife was also of Indian origin. She'd been born in India, very clearly had a domicile of origin in India, but on coming to the UK had strongly expressed a desire to remain in the UK permanently. She had

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[7] [2014] EWCA Civ 119.

very definite plans. She was a doctor; she was at Great Ormond Street. She wanted to work towards becoming a consultant at Great Ormond Street, and she was very much tied to the UK.

When they moved to Singapore because White & Chase, the law firm, moved them there, she understood that it was a temporary move. Unfortunately, the marriage fell apart when they were in Singapore. She petitioned for divorce in the UK and the trial judge concluded they were both domiciled in the UK. The move to Singapore was temporary. The firm could have moved them on to another country or to the US or back to the UK. They were not domiciled by choice in Singapore, and in particular the wife strongly maintained her link with the UK.

U v J is another divorce case.[8] Here, there is an interesting set of facts, because husband and wife had a very strongly peripatetic life pattern. The husband was born in India, moved to the UK at the age of 13, completed his education here and then became an international civil servant, first for the UK

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[8] [2017] EWHC 449.

Government and then for the European Union. He spent much of the rest of his life in a number of postings all around the world.

The wife had a domicile of origin in Ireland. She'd only ever spent two years living in the UK but nevertheless she regarded the UK as her home. Every time she finished her posting (she was also an international civil servant) she came back to their home in the UK. The two of them were based in the Balkans and in different parts of the world: a peripatetic life pattern, very much like the sort of pattern of life of many of our clients these days. Nevertheless, the wife's base was very clearly in the UK. For the husband, it wasn't so clear. The husband had indicated that he might well have gone to spend his last days in either India or Italy, so his domicile of origin in India have revived. For jurisdiction it was enough to show that one of the parties had a domicile in the UK, and that was very clearly the wife here. So, even with a fact pattern of bases in lots of different countries, the court determined what was the permanent home for the wife. Having only spent two years in the UK was enough to have made her domicile of choice in the UK and to have that as her permanent home.

The one tax case recently on this is the case of *Henderson v HMRC*.[9] The four Henderson children wanted to use the old procedure (which unfortunately has now been abolished) under Section 42 ITEPA and Section 207 ICTA to determine that they were not UK domiciled. The Revenue had determined that the four children, who were all minors, had UK domiciles and the children wanted to challenge this. The challenge was based upon the domicile of their grandfather. So this is one of those cases where you have to go back through their father to their grandfather to work out where the domicile was.

The grandfather had moved to Brazil back in the 1960's to work. He'd met his wife there (the grandmother); she was of Brazilian origin and they lived in Brazil for five years before returning to the UK, and then remained in the UK with the grandfather for the rest of his life.

The father was born in Brazil, but he moved back with his parents when he was three years old. The claim was that he had a domicile of origin in Brazil

[9] [2017] UKFTT 556 (TC)

and he had never acquired a domicile of choice in the UK, and so the grandchildren born in the UK effectively inherited the Brazilian domicile through their father and grandfather.

The mother of the children was born in the UK, but she had New Zealand origins (so quite international there). The family failed on every one of the grounds. The FTT Judge said the grandfather was never in Brazil long enough to acquire a domicile of choice there. He was there for five years, he was there for work, and didn't intend to remain there permanently; he came back to the UK and stayed in the UK.

The father, if he did have a domicile or origin in Brazil, when the grandfather moved back to the UK he resumed his UK domicile and that became the domicile of dependence of the father. Even if the father didn't have a domicile of dependence after he was 16 years old, the father acquired a domicile of choice in the UK. So on every ground the family failed to establish domicile outside the UK.

Finally, the most recent of the cases on substantive law, and the only one where I think it really adds something new. Up to now, most of these cases have been illustrative of the established rules The only one that maybe adds something new is the case of ***Proles v Kohli***.[10] Again, it's another claim under the Inheritance Family Provisions Act.

Mr Kohli was domiciled originally in India. He only lived in the UK for about 12 years. He came in 2003, his wife remained behind in India, and he continued to go to visit her in India. While in the UK he formed a relationship with the mother of the child who was making the claim against his estate.

While he was in the UK he was quite active both in terms of acquiring a number of properties and establishing quite a lot of social connections. He was very involved in the local country club, he had lots of friends in the UK, and the High Court decided that within a couple of years of coming to the UK he had acquired a domicile of choice here.

The interesting and novel element is that sadly Mr Kohli was diagnosed with cancer. He was treated for a time, and then it became clear that the treatment was not being successful. The treatment was

[10] [2019] EWHC 193 (Ch).

withdrawn and it was then terminal. At which point in time he returned to India for the last month of his life, the last 30-odd days. He went back to India and the question was whether that showed that, even for just that short period of time, he abandoned his domicile of choice in the UK because he wanted to end his last days in India. “No”, said the Master in the Chancery Division, upheld by the Judge of the Chancery Division. He was not abandoning his domicile of choice. By that stage (and it is a rather sad way of putting it), by that stage effectively he had no life left. He knew that he was terminally ill, it was simply a matter of days, and it wasn’t a decision that he was going to live permanently in India but simply that he wanted to pass the remaining days in the country that was familiar to him. To quote from the judgment:

> “Indeed, even if the deceased had travelled to India intending to die there, this would not, in my judgment, be an abandonment of his domicile of choice, for similar reasons. Where, for practical purposes, a person has no life left to live, then a decision to go to his/her country of origin to die, is not a decision to spend any significant part of one's life ("the end of one's days") in that country - it is a

> decision that the specific event of his/her death should be in that country."

I have to say it is sad to be talking about this but I certainly have had one occasion in the past where I had a client who had gone abroad and established a domicile outside the UK. He then became terminally ill and needed medical treatment which was best in the UK. He was faced with a dilemma because he worried that if he came back to the UK for treatment and died here that would revert to his previous domicile of origin in the UK.

We took the view that his health and what was best for him was much more important than the tax if he came back to the UK, and he did die here. I don't believe that the Revenue challenged that he died domiciled outside the UK. In a sense this judgment is helpful for those who face clients in this situation where the client may be terminally ill, may wish to come back to the UK for treatment, but be worried about the possible impact on their domicile.

That is really the only new element I have discerned from the cases. So, let me just draw a couple of points together on the substantive law cases.

The law is very well settled and none of those cases argued that the law should change or any of the decisions were wrong. The cases all turned on their specific facts and they also turned very much on the burden of proof. The burden of proof is on the person who seeks to show a change of domicile, so sometimes the burden shifts during a case. There is a broad examination of lifetime events, but there are certain points that are clearly highlighted in the cases: for example, acquisition of property in the UK, a number of the cases show how the individuals come into the UK bought several properties in the UK. Personal statements were of assistance, provided they were consistent with what the individual actually did. A starting point in many of these cases was that the individuals had resided for a long period in the UK, but that is by no means conclusive. One can live in the UK for 56 years but that will not necessarily indicate an intention to reside permanently or indefinitely. I have noted the emphasis on where somebody intends to spend the last days of their life. As the last case suggests, if somebody does eventually leave the UK (or come back to the UK) because their life is effectively ending, that will not change things.

Cases on procedural issues

I would now like to consider some procedural cases in relation to domicile because it is one thing to have a good argument about domicile but it is another thing to actually be able to get that determined by a Court.

Just to note a couple of earlier cases. In the *Wrottesley* case,[11] Lord Wrottesley attempted to have a trial of a preliminary issue on his domicile of origin. He just wanted to have determined whether he had a domicile of origin in Ireland or not. The Upper Tribunal said that that would not be a suitable matter to be tried by itself as a preliminary issue.

Similarly in the *Gulliver* case[12] the Chief Executive of HSBC had a domicile enquiry. He applied for a closure notice and that was refused. The basis of his claim was that he had effectively tested his domicile by setting up trusts some years earlier with an amount just in excess of the nil rate band (this is one of the ways people have used to get the Revenue to take a view) and the Revenue had issued a letter

[11] [2015] UKUT 637 (TCC).
[12] [2017] UKFTT 222 (TC).

confirming that when he created the trust he was non-domiciled (and therefore there was no inheritance tax liability because it was an excluded property settlement). Despite that, the First-tier Tribunal said that this letter was not conclusive for later years. The Revenue could take a different view for later views and therefore it was appropriate for the Revenue to continue their enquiries and the closure notice was refused.

That is by way of a prelude to some cases that I want to consider here.

Procedurally, unfortunately at the moment we have no procedure for getting a domicile ruling from the Revenue. The Revenue ceased giving domicile rulings several years back. Instead, one has to fill in a self-assessment tax return claiming non-domicile status and that may lead to enquiries. Experience in the last couple of years is often those enquiries are very lengthy. During those enquiries it is not at all unusual for the Revenue Officer to change (several times) and to be asked again questions that have been asked previously. A few years ago I was involved in a couple of long-, long-running domicile enquiries where we had been through two, three or even four Revenue Officers, and the new officers coming in were asking for the same information and the same documents that their predecessors had asked two or three years previously. It was very irritating for the clients because they were being asked the same questions and it was costing them additional fees.

A question arises as to how you actually get the Revenue to take a definitive decision and come to a view. If the Revenue concludes the taxpayer is actually UK-domiciled and not entitled to the remittance basis, then the question arises how much unremitted income or gains should have been taxed in the UK. The Revenue won't have that information and the taxpayer may not want to give it to the Revenue because, if the taxpayer is actually non-domiciled and the Revenue have got it wrong, then, of course, the Revenue are not entitled to that information. So we have a sort of Catch 22 situation where the Revenue want the information about unremitted income, and the taxpayer says the Revenue are not entitled to it, but the Revenue says "Yes, you are domiciled" and the taxpayer says "No, I am not".

So, we end up with a conflict because the Revenue issue information notices for details of the unremitted income, and the taxpayer seeks a closure notice saying "I want it to be determined that I am not domiciled" (in which case it is unreasonable for the Revenue to ask for this information because they are not entitled to it). So, we have a conflict between two procedures. That raises questions that have come before the Tribunal on partial closure notices. Can that be issued to determine the question of domicile? That is, on an application for a PCN, can the Tribunal determine the question of domicile? Can a PCN be issued by the Revenue simply to say that it has been decided that you are domiciled in the UK. and you can therefore appeal that, or do the Revenue have to determine quantum when they issue a PCN?

There are some conflicting decisions from the First-tier Tribunal on this.

First, the Levy case.[13] The taxpayer had been born in the US, she'd lived in the UK for 40 odd years before she died, and the Revenue concluded that a few years before she died she had become domiciled. The

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[13] [2019] UKFTT 418 (TC).

Revenue reached that conclusion and said they needed to know the unremitted income. The taxpayer said, "No, you are not entitled to that, and I want a partial closure notice so that I can appeal on the question of being domiciled". The question was for the trial judge was whether he should resolve the domicile issue on the application for a closure notice. In other words, when the closure notice was applied for, could he decide on the law and the facts that she was or was not domiciled. The judge said that, at that stage, he could not decide that issue. He could decide whether or not to issue a PCN, and he could do that even though the amount of tax had not been determined. So he could issue a PCN, but could not decide whether she was domiciled or not.

In this particular case though, the judge concluded that it was perfectly reasonable for the Revenue to continue their enquiries and to seek the information about the amount of unremitted income.

The second of the cases is the Henkes case[14] and a very long judgment of Judge Beare. He concluded that on an application for a closure notice you could

[14] [2020] UKFTT 159 (TC).

go ahead and decide the question of domicile. He could decide on the law and on the facts whether Mr Henkes was, in fact, domiciled in the UK or not. He came to the conclusion that Mr Henkes, who originated from Venezuela but had come and lived for most of his life in the UK, was, in fact, domiciled by choice in the UK. Mr Henkes had retired some 10+ years before, but was still working in the UK and treated his Spanish house as a holiday home, so the UK was his chosen permanent home. On that basis the Revenue had reasonable grounds for not issuing a closure notice and for seeking information about the unremitted income.

The taxpayer had taken this route of appealing against an information notice and asked for a PCN. There is no appeal against the decision to uphold an information notice. The FTT's decision on that is final, but one can appeal against a PCN. So, in principle, Mr Henkes could have appealed against the determination that he was domiciled in the UK. In fact, no appeal was actually lodged in that case.

What one may take from that case is Judge Beare's very careful judgment saying that he could decide on a PCN application whether or not somebody is domiciled. The Tribunal could hear submissions on the law and the facts and could decide the issue.

Most recently, in the case of Perlman,[15] however, Judge Redstone has reached a different conclusion. The Revenue issued an information notice for details of unremitted income. The taxpayer objected that this information was not reasonably required if he was non-domiciled, and asked the Tribunal to determine his domicile at the hearing. Judge Redstone concluded that she had no jurisdiction to demine that issue at that preliminary stage, and, even if she had jurisdiction, it was not appropriate to exercise it.

Meanwhile, and this is the last case I am going to mention, the Embiricos case,[16] another domicile case. The question that arose here was again whether a PCN could be issued without identifying the amount of unremitted income. In other words, could the Revenue simply issue a closure notice stating that the taxpayer is domiciled in the UK, and then the taxpayer could appeal on that without any question of the amount of tax. The Upper Tribunal, reversing

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[15] [2021] UKFTT 219 (TC).
[16] [2020] UKUT 370 (TCC).

the First-tier Tribunal and disagreeing with Judge Scott in Levy, concluded that a PCN cannot decide just the domicile question. It needs to contain a conclusion on the amount of tax, and so until you know the amount of tax no PCN could be granted. That case is understood to be going on appeal to the Court of Appeal which will have a chance to re-examine that issue. That decision will have implications for the procedure in closing enquiries. In domicile cases, if you can only get a PCN which identifies the amount of income, then the Revenue are entitled to take a view that somebody is domiciled, obtain the information about unremitted income, and then issue a PCN. It follows that the Revenue are entitled also to get an information notice; it would not be unreasonable for them to ask for information about unremitted income.

So, procedurally, we are something up in the air. We have Levy going one way, Henkes going the other, and Perlman not following Henkes. We have the Embiricos case which is going to the Court of Appeal on the scope of a PCN.

What this underlines is that there is a need for a procedure to determine a taxpayer's domicile. It should not require an entire investigation into amounts of income and gains to determine a preliminary issue: if a taxpayer is non-domiciled then the amounts of unremitted income and gains is irrelevant. It is in the interests of all parties for there to be a procedure for determining the preliminary issue of domicile.

Domicile enquiries

Regarding domicile enquiries, just a few points.

First of all, the page from the domicile and residence manual, which lists 70 questions that may be asked. This is a huge number of questions that the Revenue suggest as a possible schedule for a request for information and documents about domicile. The basis for this is the unfortunate statements in some cases that issues of domicile may involve a detailed examination of the minutiae of an individual's life. However, that is not true of all cases, and in some cases it may be that there are key pointers to determine domicile in one direction or the other. As a practical matter, however, anyone who is claiming domicile outside the UK will need to be able to answer the list of questions, or as many of them as there is evidence for, and to provide documentary evidence where available. It is good practice to have this material ready if a claim for non-domiciled status is being made.

Finally, a word about the significance of naturalisation in the UK. It is clear that you can be naturalised in the UK without acquiring a domicile here. That is partly based upon a technical point of law that, in order to become naturalised under Section 6 of the British Nationality Act, you have to show that your *principal* home will be in the UK, not your *permanent* home. So, the key question is what you actually say: if you say you are going to make your principal home in the UK but not your permanent home, that does not necessarily read across to the acquisition of domicile here.

Having said that, in December last year the Home Office issued an updated set of guidance on naturalisation as a British citizen. In that they stated specifically that on a naturalisation application they may seek to contact HMRC to find out what an applicant for naturalisation had said in connection with their domicile, and specifically whether in their domicile questionnaire they had indicated that they did not intend to make the UK their principal home.

Whether it is appropriate for the Home Office to make such enquiries is a separate question. However, there is a key distinction to be carefully made here between the UK as principal home and the UK as permanent home.

THE SUPREME COURT

Riding to the Rescue

Peter Vaines

Decisions of the Supreme Court are of course supremely important. Decisions of the other courts are of course also important and represent authorities – but they can be, and are frequently, criticised for many and varied reasons. There is no arguing with a decision of the Supreme Court. It represents the law. Therefore it is right, even if it is wrong, philosophically speaking.

The Supreme Court also sets the scene or provides the framework for the application of the law and it is for this reason that the taxpayer can take comfort from three decisions this year on important aspects of tax law.

It has often been said with regret that the Ramsay Doctrine and its derivatives, and the application of purposive interpretations, seem never to apply in favour of the taxpayer. They only ever seem to apply as a means of countering tax avoidance perceived by HMRC. The challenge is that if these were genuine principles of statutory interpretation, then the tax case reports would reveal more balanced numbers in their outcomes – both for and against the taxpayer.

It is said by HMRC in defence of their approach when denying a relief or advantage claimed by the taxpayer, that Parliament could never have intended that result – even if the law expressly says so. However, when the taxpayer makes the same claim – as for example in the cases of *Lobler* or *Dickinson* – there is nothing that can be done. It is the law.

This has recently been exemplified by a change of practice by HMRC on the legislation regarding the remittance basis and the effect of collateral over an individual's foreign income and gains. Their (new) view is based on their interpretation of the law – but their interpretation (although perhaps tenable) is utterly devoid of merit and cannot possibly have been the intention of Parliament.[1]

Every experienced reader of tax cases will have seen this argument many times. Indeed, no taxpayer (or his advisor) ever says that their arguments will succeed on the basis of a purposive interpretation – but they all

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1 *For further details on this point see my Tax Bulletin: July 2021 on the chambers website*

fear that they may lose on such a basis.

Maybe it is only right that HMRC should win (as they claim) 80% of tax cases involving tax avoidance. But instinctively this sounds like something is wrong. It must be acknowledged that some taxpayers push the envelope too far and deserve to lose. However that this is not always (and I would suggest, not usually) the case. Most taxpayers involved in litigation beyond the FTT know what the law says (they are not complaining that it should say something else) and they are arguing about what it means. It may therefore be questioned why their arguments have only a 20% chance of success. Does this give support to the challenge that it is something to do with how statutory interpretation is approached in tax cases?

The misleading mantra – that HMRC are only trying to ensure that the taxpayer pays the right amount of tax – is an emotive and self-serving approach and should not trump the proper application of the law.

There have been chinks of light where the taxpayer has seen that a purposive interpretation might be applied to his advantage and the point has now been decisively settled by the Supreme Court in the case *of Balhousie Holdings Ltd v HMRC [2021] UKSC 11.*

The case involved a question of VAT zero rating and Lord Briggs said that tax cases exemplify the general rules:

> "The ultimate question is whether the relevant statutory provisions construed purposefully, were intended to apply to the transaction, viewed realistically"

He went on to say with reference to purposive interpretations:

> "it is nothing to the point that the present case is not about tax avoidance, or that it is about VAT rather than taxes on income or gains. This principle of statutory construction is of general effect"."

This is clearly welcome. Where the taxpayer is arguing for a result which is clearly contrary to the will of Parliament, he is likely to be unsuccessful – and that will not change. Where HMRC are arguing for a result which is clearly contrary to the will of Parliament, it is only right that they should not prevail either, and that a purposive interpretation should come to the rescue of the taxpayer

The Supreme Court have confirmed that the taxpayer has an unequivocal right for legislation to be interpreted purposively to avoid a result which is clearly unfair and this must surely be applauded.

When it comes to tax legislation, HMRC has some awesome weapons at its disposal, two of them being Accelerated Payment Notices and Follower Notices. These have been described by the Supreme Court as draconian. They allow HMRC to require the taxpayer to pay tax before any liability has been established – and worse, even before the merits of the issue have been considered. And the taxpayer has no right of appeal.

Where a taxpayer has entered into arrangements which he considers provide him with a tax advantage and HMRC form the opinion that a previous court or tribunal ruling has already decided that arrangements like his are not effective, HMRC may serve a Follower Notice, denying him the tax advantage and requiring him to pay the tax.

If the taxpayer disagrees and maintains that he is entitled to the tax advantage he has claimed, then if he ultimately loses his case before the Courts, he will be subject to a substantial penalty. This regime is indeed "severe" as the Supreme Court has said.

The requirement for a Follower Notice is that there must have been a relevant "judicial ruling" to the effect that:

> "the principles laid down, or reasoning given, in the ruling **would,** if applied to the chosen arrangements, deny the asserted advantage or part of that advantage"

Section 205(3(b) Finance Act 2014

In the case of *R(on the application of Haworth) v HMRC [2021] UKSC 25* HMRC took the view that the arrangements undertaken by the taxpayer were sufficiently similar to those which failed in the case of *Smallwood* that Mr Haworth was unlikely to succeed in his claim.

The Supreme Court said that was much too weak a test as a matter of language, particularly having regard to the severity of the consequences for the taxpayer of such an interpretation. They said that to satisfy the condition in section 205(3)(b), HMRC must form the opinion that there is no scope for a reasonable person to disagree that the relevant ruling denies the tax advantaged claimed. Only then can they be said to have formed the opinion that the relevant ruling would deny the tax advantage.

Given the conspicuous lack of success of taxpayers seeking to challenge Follower Notices, the decision of the Supreme Court is another welcome development in the protection of the taxpayer when faced with seriously draconian legislation, preventing the scope of Follower Notices being extended beyond the purpose for which they were intended.

The third case of significance is the Supreme Court decision in *Tooth v HMRC [2021] UKSC 17* relating to the meaning of "deliberate inaccuracy" in the context of an enquiry into the affairs of a taxpayer and the ability for HMRC to raise discovery assessments.

The normal time limit for the making of an assessment by HMRC is four years from the end of the year of assessment to which it relates. But if an insufficiency of tax is brought about by the taxpayer's carelessness, the time limit is extended to six years and if it is brought about by his deliberate conduct, it is extended to 20 years.

More precisely, section 118(7) TMA 1970 provides as follows:

> "In this Act references to a loss of tax or situation brought about deliberately by a person include a loss of tax or a situation

> that arises as a result of a deliberate inaccuracy in a document given to HMRC by or on behalf of that person".

HMRC argued that if the taxpayer submits a tax return deliberately (that is to say, not by accident) and it contains an error, the test is satisfied. There is an inaccuracy and the return was submitted deliberately. End of. Moreover this applies even if the error is innocent, and indeed, even if there is no carelessness.

The Supreme Court firmly rejected this approach. Their Lordships held in the clearest terms that for there to be a deliberate accuracy there must be an intention to mislead the Revenue on the part of the taxpayer as to the truth of the relevant statement.

This too is a welcome clarification not least because of the absurdity (pointed out by their Lordships) that on the argument of HMRC, even a taxpayer who had taken reasonable care, and would not even have been exposed to the six year extended time limit, could still be regarded as having acted deliberately and been subject to the 20 year time limit. That would be a matter with extremely serious consequences regarding penalties, and the possibility of being included in the public register of Deliberate Tax Defaulters with all the reputational damage that would ensue.

This is perhaps another example where the interpretation of HMRC is one which could not possibly have been intended by Parliament – although one might say that it did not need a purposive interpretation to reach that conclusion.

My purpose is citing these three cases is to highlight the possibility (or perhaps hope) that the Supreme Court is adopting a more sympathetic approach to the taxpayer than has been apparent in the past. I would submit that this is not only welcome but essential. Where the State treats its citizens unfairly and provides them with no remedy for such unfairness, they sow the seeds of discontent and hostility which inevitably leads to a decrease in compliance. The UK enjoys the enviable advantage that the majority of taxpayers willingly comply with their tax obligations, so anything which undermines that culture would be self-defeating.

It may be that despite my age and experience, I am foolishly naïve to believe that fairness and integrity on one side begets fairness and integrity on the other. I hope that I am not.

THE RESIDENTIAL PROPERTY DEVELOPER TAX – BIRTH OF A SUPER TAX?

Katherine Bullock

Ever since the release of the consultation document on 29th April this year, much comment has been made about the new proposed tax on UK residential property development, the Residential Property Developer Tax, or RPDT for short. This is to be expected; the prospect of a new tax is enough to give even the most hardened tax practitioner pause. Whilst of immediate interest to companies operating in the sector, the proposed tax is of more general interest also as a possible template for future taxes.

RPDT is proposed to apply from 1st April 2022 on profits in accounting periods ending on or after that date. It applies to a company or group of companies that undertake residential property development activities in the UK and generate relevant profits that exceed the £25million annual allowance. Only profits above the annual allowance are subject to RPDT at a yet unspecified rate.

The tax is an entirely separate tax with its own complex rules and definitions and is levied in addition to corporation tax. Although many features of the new tax will doubtless seem familiar to veterans of the corporation tax code, there are hints of change that might ultimately transfer to the corporation tax code.

A Super Tax

So why is RPDT a super tax? Firstly, it is time-limited, running for a decade to raise a targeted £2 billion. However, if the target is not met the tax may be extended. It will be interesting to see the mechanism by which this will be achieved. It is always possible of course that the tax becomes a permanent feature of the UK tax landscape. After all income tax was originally envisaged as a temporary measure to fund the Napoleonic Wars and it remains a temporary tax expiring on 5 April each year and voted back into being in the annual Finance Bill. For now, a new time limited tax may be more acceptable than a general increase in the rate of corporation tax.

Next, these revenues are hypothecated; that is ring fenced to cover the cost of remediation work following the Grenfell Tower tragedy. We often see tax revenues raised with the intention of funding a particular cause; for example, the SDLT non-resident surcharge was introduced to raise funds to help the homeless. However, revenues are rarely ring fenced for a particular cost as proposed here.

Finally, it moves the tax burden from the general taxpayer to the residential property developer who it is argued will profit the most from restored public confidence. As the whole sector will benefit, the tax is not limited to developers of high-rise buildings, nor does it make allowance for any company that has already paid for or undertaken remedial work. According to the consultation document, RPDT "is not intended to imply responsibility on behalf of the payers for historical construction defects in relation to cladding"; however, it is possible that large developers and particularly high-profile investors, such as pension funds, may hesitate to avoid or mitigate a tax raised for such a cause for fear of public approbation.

A tax on only the largest developers

RPDT is supposedly intended to land on the broad shoulders of those most able to bear it. This policy objective is secured by the £25m annual allowance with only profits above this being subject to tax. However, as many property investors discovered with the corporate interest restriction, the threshold may not be as generous as at first appears. More taxpayers may find themselves within the scope of the tax than might otherwise appear for the following reasons: firstly, the nature of the allowance itself; secondly, the calculation of the profits taxed; and thirdly, the definition of residential property development.

Nature of the allowance

The annual allowance applies on a group basis and is divided between the companies in the group. Any unused allowance cannot be carried forward. With RPDT, the Government seems to anticipate a new concept of a single economic entity noting that "group definitions that rely on control, ownership of share capital, and/or rights to distribution of profits or assets in a winding up may not capture the UK residential property profits of what might reasonably be considered a single economic entity". This may herald wider changes for the corporate tax code generally and for now the added complication of needing to determine the relevant group companies for RPDT as well as for corporation tax purposes.

Joint ventures with a relatively significant economic interest, yet to be defined, in a vehicle liable to RPDT will also fall within the scope of the tax. Where the joint venture is undertaken through a tax transparent entity, each partner will be subject to RPDT on a look through basis and subject to tax as normal. However, where the joint venture vehicle is not transparent, a two-tier approach is proposed. Firstly, RPDT would be charged at the level of the joint venture vehicle as if it were a stand-alone company. RPDT would also be charged on any profit realised at the level of each joint venture member where that member has a significant economic interest in the joint venture. Credit would be given where profits are subject to tax twice. This should ensure that additional residential property development activities of one joint venture member do not take another investor over their annual allowance.

Calculation of profits

Profits for these purposes are calculated before interest and finance costs, which are often a very significant deduction for property developers.

Companies who do not consider themselves large developers may well find they are when profits are calculated on tax-EBITDA. This restriction may also indicate a wider desire on the part of HMRC to remove any deduction for interest and finance costs for UK tax purposes generally. The consultation document explains, “To prevent distortions of the tax base for the RPDT depending on differing models of how interest is allocated, the government proposes that interest and other funding costs would not be allowed as a deduction against RPDT profits.” Many developers may argue with some justification that debt funding is simply standard commercial practice.

No deduction will be allowed for losses incurred before 1st April 2022. The consultation says, “While the government recognises the economic and fairness arguments for allowing losses to be carried-forward it would mean for all models the creation of a new category of RPDT losses and specific loss streaming rules, which would add a significant layer of complexity into the new tax and would move the RPDT further away from the standard CT rules.” It is unclear if the carry forward of losses arising post 1st April 2022 will be permitted raising the spectre of tax on profits but no relief for losses. Similarly, group relief surrendered for corporation tax purposes and attributable to non-residential property development would be added back. Given that property development typically produces assets in phases rather than smoothly over time it is possible that developers could be unexpectedly brought into the charge to RPDT. Smooth profits that keep each year below the allowance may be preferable to the more typically unevenly distributed profits and a preference for these kinds of project profiles may distort the housing market.

Two potential models are put forward to calculate the tax. Both models would apply to stand alone companies and groups of companies that undertake any amount of residential property development or support that work in other companies in the same group.

Under Model 1, the company or group would be taxed on its total profits if more than a de minimis amount of development activity on UK residential properties takes place. What is considered de minimis and on what basis it will be calculated has yet to be decided. Accordingly, profit arising from other activities, such as commercial or mixed development, would also be subject to RPDT. With this model, the impact of RPDT would depend on both the group structure and the company or group's other activities. In short, under Model 1 any company exceeding a de minimis threshold of residential property development will pay RPDT on its entire taxable profits. This model offers simplicity at the cost of fairness.

Under Model 2, all entities will have to calculate how much profit is generated by UK residential property development activity and then pay RPDT on that amount. This approach is more focused in its ambit but at the cost of significant complexity. Essentially this model taxes only residential property development profits but regardless of how much residential property development is undertaken. It is suggested that these profits may be calculated on the basis of corporation tax or an adjusted consolidated accounting basis in line with UK GAAP. Computing taxable profits based on existing corporation tax principles would be more consistent with the corporation tax code and therefore might reduce the compliance burden. Even so, with Model 2 the end result may be fairer but clearly a group will need to be able to separate out the relevant profits and justify their calculation to HMRC. How this apportionment must made and in particular the apportionment of centralised costs, remains unclear.

The CIOT suggests at paragraph 9.4 of their response to the consultation document that it might be desirable to allow for an (irrevocable) election into a particular model. This seems a reasonable approach but flexibility as to the timing of such an election, particularly in the case of smaller developers who find themselves brought unexpectedly within the rules would be welcome.

Meaning of residential property development

The tax, whilst called a tax on residential property developers, is more accurately descried as a tax on residential property development. Both development and residential property is very widely defined. Whilst third party residential construction companies unconnected with the landowner will not pay RPDT, the developer will pay RPDT regardless of whether the development is undertaken in-house or third-party contractors are used.

Build to Rent

Residential property development for these purposes includes both developers building to sell, where land is held as stock, and investors building to hold as a long term investment, known as build-to-rent. This is not therefore a tax that property investors can safely ignore. For build-to-rent companies especially this raises the prospect of a dry tax charge when the development phase ends.

Where a property is sold or transferred within a group after completion of the development phase, RPDT will be calculated on the arm's length profit at that point. Where there is no such sale or transfer, RPDT will apply to the fair value of the development upon the initial rent less the costs of development.

In the Government's view "excluding such developments could lead to distortions and unfair treatment - for instance by excluding from the RPDT developments that are rented briefly on completion before being sold". Groups that have diversified models including sales and build-to-rent should not be differentiated from competitors with sales only models. As the CIOT have pointed out in their response [para. 8.3] "a simpler solution might be to consider adopting a similar protection to that offered by the three-year development rule for REITs (CTA 2010 section 556)."

Residential property

The tax is confined to residential property in the UK, but RPDT will be assessed on non-UK resident companies with a UK permanent establishment or falling within the offshore property developer rules, who do not benefit from treaty protection.

Disappointingly for those arguing for a single definition of residential property across all taxes, RPDT will have its own definition, although bearing a close resemblance to that for SDLT. The proposed definition includes any single residence along with its grounds, gardens, and any land intended to benefit the dwelling. It will include buildings suitable for use as a dwelling even if not so used at the time; existing buildings being adapted, restored to, or marketed for domestic use; and undeveloped land where a residential building is being or would be built upon it. Whilst much is borrowed from the SDLT definition in the Finance Act 2003 section 116(1)(a), there are some critical differences. The marketing test is new and suggests that marketing a building as having residential potential may be sufficient to determine its status as residential property. The test also encompasses residential property that 'would be' constructed, potentially bringing profits from sales 'off plan' into scope. RPDT appears therefore to apply whether the land is sold as bare land, at golden brick stage or on completion and whether conversion or new build.

It is inevitable that the test of whether a company is developing land or investing in land, particularly when it obtains planning permission pre-sale, will become even more critical. Farming companies and land pooling companies need to be particularly careful where windfall profits or overage based on actual residential development arises. Under the current definition RPDT may include within its scope the sale of bare land and the uplift in value from the grant of planning permission, unlike the transactions in UK land code which excludes gains accruing prior to the formation of an intention to realise a gain from disposing of developed land.

Whilst developers of communal dwellings such as hospitals, prisons, and hotels are excluded from the scope of the tax, it is interesting that affordable housing associations where the charities exemption does not apply, residential homes for the elderly which do not provide care and purpose-built selfcontained student accommodation which is seen as competing with the wider sector may be caught. The consultation document is silent on whether local authorities and pension funds will be exempt, and the current proposals as regards joint ventures suggest at least an indirect charge is possible on such investors.

Anti-avoidance

No new tax would be complete without its own anti-avoidance code. RPDT will come complete with anti-forestalling provisions to prevent the acceleration of profits, anti-fragmentation provisions to prevent the dissipation of profits and anti-avoidance provisions to prevent the recategorization or disguising of profits. Profits will also be prevented from falling out of charge by selling the company rather than realising a development profit. The consultation suggests that “The most appropriate mechanism to deliver these safeguards would depend on the structure of the tax but may involve degrouping charges or measures similar to the transactions in land rules, permitting RPDT to be charged on profits and gains derived from residential development profit”.

Whilst the anti-avoidance code should address the acceleration of profits, the relatively short life of the tax may encourage the delaying of developments and the consultation document clearly contemplates the potential disruption to the housing supply that could arise through attempts to spread profits across a number of accounting periods. They are right to be concerned; after all, this was the case with development land tax.

Concluding thoughts

Much of the above may be, and is indeed likely to be, subject to change. Not all of the information required to judge the tax's impact on a particular case is available. Perhaps this is a tax that sets out too many often-conflicting aims. Regardless, it is likely to be horribly complicated relative to its limited yield in fiscal terms. It will certainly increase the burden of tax compliance by introducing a significant extra layer of complexity. This then raises the question: why take such a route when simpler and more effective methods are available?

Nevertheless, it is not safe to ignore RPDT. Sensible steps to take in the interim include modelling the two methods of calculation, considering the current group's structure and how future development profits are likely to fall, particularly if the property will be retained, and clearly evidencing investment intention where appropriate. With nine months to prepare, it is time to act.

EQUITY RELEASE, THE SAAMCO CAP AND COUNTER-FACTUALISM

David Southern QC

Asset rich and cash poor

Individuals and businesses may be asset-rich but cash poor. Much of English land law derives from the problems of medieval landowners who were wealthy but had no ready cash, e.g. to pay feudal duties to the monarch or dowries for the marriage of a daughter. They would mortgage the land to money-lenders who would become the temporary owners of the land while the loan was outstanding.

An illiquid asset was thus converted into a liquid asset. The illiquid asset would be monetised. The same practice applies to this day, with the replacement of the transfer of the land to the lender by the device of the legal charge over the land.

Equity release

Equity release has been popular in the last 10 years. The Government has encouraged people to cash in their pension funds ('Sunny afternoons with flower pots rather than pension pots'). Companies have undertaken share buybacks to improve future return on capital employed figures.

Equity release loans

As a means of lifetime giving, equity release offers a number of benefits. The money raised (say £50,000) can be given to a child or grandchild, e.g. to pay the deposit on a house purchase. This will be a potentially exempt transfer of value, which becomes wholly exempt if the donor survives the gift by seven years. If by the time of the death of the donor, the loan secured on the property has grown to £60,000, that is deductible for inheritance tax purposes. In such a case the equity release anticipates what would otherwise happen later, and provides a saving of inheritance tax of up to £24,000.

The position of the lender

In substance the homeowner has sold a share in his house to the mortgage release company, which is in the position of a purchaser rather than a lender. In legal terms the transaction is a loan. However, an equity release is a highly unusual loan: (i) it remains outstanding indefinitely, without a fixed date for repayment; (ii) the lender has no right to call for repayment, while the loan is outstanding; (iii) the lender is exposed to interest rate risk for an indefinite period.

<u>Hedge accounting</u>

Having regard to these particular features of lifetime mortgages, the lender will seek to protect himself from interest rate risk and fix his profit by entering into floating-to-fixed interest rate swaps, so converting his actual fixed rate loans to customers into synthetic floating rate loans, which in commercial terms he can match with his funding costs.

As the lifetime mortgages are long-term assets, the lender will account for them at book value (amortised cost). The first rule of International Financial Reporting Standards (IFRS) is that all derivative contracts, because their values are highly volatile, must be fair valued and taken to balance sheet. Hence there is a fundamental accounting asymmetry between the mortgage assets (historic cost) and the hedging transactions (fair value). Profits and losses on the swap contracts will be recognised in the income statement, as they arise. Corresponding losses and gains on the lifetime mortgages will only be recognised when the loan is repaid. This introduces volatility into the income statement which does not reflect the economic relationship between the hedged item and the hedging instrument.

The solution is hedge accounting. In narrowly defined circumstances IFRS allows hedge accounting, e.g. in the case of a fair value hedge the carrying value of the hedged item is adjusted for value changes in respect of the hedged risk. These items in the income statement should balance the equal and opposite gains and losses on the hedging contracts. However, because this is such a fundamental departure from fundamental principles of IFRS, hedge accounting is only allowed if the hedge meets a series of conditions and is ‘highly effective’ [IFRS, para 6.4.1; IAS 39. AG105].

In such circumstances it will be a ‘designated hedge’, i.e. one recognised for accounting purposes.

Tax treatment

The requirements of the UK tax system are more flexible. The system allows designated and undesignated hedges alike to be recognised for tax purposes, so as to smooth taxable profits. This is achieved through the famous Disregard Regulations (SI 2004/3256).

Regulatory issues

Providers of equity release loans are in general regulated bodies, such as banks and insurance companies. A regulated lender has to maintain a prescribed ratio between his risk-weighted debt assets and his equity reserves. If his reserves suffer a sudden sharp reduction, he will have to reduce his assets or liabilities or both. The commercial significance of hedge accounting will include its impact on the group’s regulatory capital position.

Manchester Building Society

The problems which can arise with lifetime mortgages were considered by the Supreme Court in *Manchester Building Society v Grant Thornton UK LLP* [2021] UKSC 20 ('*MBS*').

MBS wanted to embark on lifetime mortgages, to meet client demand for this facility. Their accountants advised that hedge accounting would be correct and could be adopted. That was in 2006. Some years later in 2013 the accountants recognised that their original advice had been incorrect. The reason was that there could be no effective hedging relationship between the lifetime mortgages and the interest rate swaps. That was because there was no certainty as to when the mortgages would mature, whereas the matching swap contracts into which MBS had subsequently entered were for 50 years.

So MBS had to dispose of the interest rate swaps at short notice. Interest rates had sharply fallen. As a result, the Society had to dispose of its hedging swap contracts at short notice, at a net cost of £26.7m.

SAAMCO

The Society blamed the loss on the accountants' original incorrect advice. The resolution of this issue required consideration of the decision of the House of Lords in *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191 (‘*SAAMCO*’)

SAAMCO concerned cases where valuers advised banks on the value of houses on the security of which banks proposed to lend money to borrowers. The borrowers were unable to repay their loans. The banks’ security proved inadequate to cover the deficit. They sued the valuers for negligent over-valuation of the properties.

While the loans had been outstanding there had been a general fall in property prices, which had added to the loss suffered by the banks. The House of Lords held that the banks’ recoverable losses were limited to those which came within the scope of the valuer’s duties. The properties against which the loans were secured had been negligently over-valued. The valuers were liable for the losses caused by the inadequate value of the security compared with the loan advanced, but not for losses caused by the general fall in property values.

To determine whether the loss should be divided into two parts in this way, the House of Lords applied a counterfactual test: what would the claimant have done, if the advice had been correct? If he would still have entered into the same transaction, the professional adviser does not take on the role of insurer or prophet. He is only responsible for the losses factually caused by the breach of duty. He is not responsible for losses of an independent kind. This is the '*SAAMCO cap'* on damages.

Applying the *SAAMCO* cap, the High Court and Court of Appeal held in *MBS* that there was no liability. An accountant who advises his client on the manner in which he should keep his accounts is not legally responsible for the financial consequences of the client's business activities.

Review of the *SAAMCO Cap*

It is a universal rule that whenever judges deprecate the risk of legal uncertainty, they increase it. In the Supreme Court all seven justices agreed that the conclusion of the High Court and Court of Appeal should be reversed. However, they produced three different analyses, why this should be. The majority of justices upheld the *SAAMCO* cap in principle, while departing from it in practice. They held that the purpose of the advice governed the scope of the accountants' duty. Here the purpose of the advice was to determine whether or not the use of hedge accounting was correct. The decision to enter into equity release business was based on that decision [34]. It was common ground that the advice was incorrect. The losses of extricating the Society from that business were therefore recoverable, though there would be a reduction in damages of 50% for contributory negligence in entering into the particular forms of swap contract.

As regards the counterfactual analysis, the Supreme Court concluded that it provided no more than a useful cross-check as to the limit to damages: [23], [27].

<u>Wider implications</u>

Hedge accounting and the *MBS* case raise a host of wider implications. To take a simple example, for the purposes of the corporate interest restriction (CIR) rules, in calculating 'relevant expense amounts' and 'relevant income amounts' under Taxation (International and Other Provisions) Act 2010, s 411, what is the impact of hedge accounting?

Anti-avoidance taxation is designed to negate the 'tax advantage' which arises from the tax avoidance motive which, it is alleged, has directed the actual transaction which the taxpayer has undertaken. In *CIR v Parker* 43 TC 396 at 441 Lord Wilberforce points out that the notion of 'tax advantage' presupposes the notion of a comparator in which the same commercial result is obtained without the accompanying tax advantage. In order for there to be a tax advantage there must be a contrast or a comparative whereby the purported advantage does not arise. HMRC must point to a comparator transaction shorn of the tax advantage.

HMRC characteristically use the counterfactual test to drive the outcome of a case to show that a tax avoidance motive is present. To take a common example, the personal service company (PSC) legislation taxes the PSC by reference to a hypothetical contract of employment between the user and the worker, the tax consequences of which fall on the PSC.

The Supreme Court in *MBS* has pointed out the intrinsic vagueness of counterfactual propositions, and the assumptions which underlie any counterfactual analysis. If I had not taken the 09.29 train from Brighton to London on a particular day, it is impossible to say what the consequences would have been, and to assess my actual actions by reference to actions which I never undertook. The *MBS* approach offers an important corrective to counterfactual analysis. The counterfactual analysis should not drive the analysis of the case, so that it becomes increasingly untethered from reality, and substitutes for tax purposes an imaginary state of affairs.