Tax update

November 2016

In this update we report on the proposed new corporate offence of failure to prevent facilitation of tax evasion, success against HMRC in the Supreme Court in relation to unlawful disclosure of confidential information and HMRC's new specialist team which has been set up to tackle exploitation of freelance workers. We also comment on three recent cases on share loss relief claims, HMRC's attempt to transfer PAYE liabilities to employees and the Tribunal's jurisdiction to consider HMRC's duty to act fairly when administering its statutory powers.

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Criminal Finances Bill published

A new Bill, *The Criminal Finances Bill*, has been introduced into the House of Commons, which proposes, amongst other things, to create two new corporate criminal offences of failure to prevent facilitation of tax evasion (UK and foreign tax evasion). more›

Supreme Court finds in favour of Ingenious Media Holdings and confirms that HMRC should not have "leaked" confidential information to the press

The Supreme Court has unanimously allowed Ingenious Media's judicial review against HMRC for disclosing information to the Times newspaper. more›

HMRC to issue fines in bid to stop exploitation of freelancers

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Stan Murray-Hession: Tribunal allows taxpayer's share loss relief claim

In *Stan Murray-Hession v HMRC*[1], the First-tier Tribunal (FTT) has held that Mr Murray-Hession (the Appellant) had subscribed for shares within the meaning of section 135(2), Income Tax Act 2007 (ITA), so that share loss relief, under section 131, ITA, was available. more›

Any comments or queries

Adam Craggs
Partner
+44 20 3060 6421
adam.craggs@rpc.co.uk

Robert Waterson
Senior Associate
+44 20 3060 6245
robert.waterson@rpc.co.uk

Michelle Sloane
Senior Associate
+44 20 3060 6255
michelle.sloane@rpc.co.uk

About this update

The Tax update is published on the first Thursday of every month, and is written by members of RPC's Tax Dispute team.

We also publish a VAT update on the final Thursday of every month, and a weekly blog, RPC Tax Take.

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Stephen West: Tribunal rejects HMRC's attempt to transfer PAYE liability to employee

In *Stephen West v HMRC*[2], the First-tier Tribunal (FTT) allowed the taxpayer's appeal and confirmed that under the PAYE system the obligation to pay income tax fell on the employer, and liability will only be transferred to the employee under the Income Tax (Pay As You Earn) Regulations 2003, if he has received his remuneration knowing that his employer has wilfully and deliberately failed to deduct PAYE. more>

Eden Consulting Services: Tribunal has no jurisdiction to consider HMRC's duty to act fairly in administering its statutory powers

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Criminal Finances Bill published

A new Bill, *The Criminal Finances Bill*, has been introduced into the House of Commons, which proposes, amongst other things, to create two new corporate criminal offences of failure to prevent facilitation of tax evasion (UK and foreign tax evasion).

UK tax evasion covers any offence of cheating the public revenue, and facilitation therefore includes, more broadly, aiding and abetting, and other less developed contributing offences. Under the proposed section 37, a company or partnership will be guilty where a person associated with it commits a UK tax evasion facilitation offence when acting in that capacity.

It will be a defence to show that, at the time of the offence, a business had in place reasonable prevention measures or that in the circumstances it would not have been reasonable to have prevention measures in place.

Under the proposed section 38 (facilitation of foreign tax evasion), the offence is almost identical save that the offensive conduct must (i) amount to an offence under the law of another country, (ii) relate to a breach of duty regarding tax imposed by law in that country, and (iii) be regarded by courts in the UK as amounting to conduct where the defendant was knowingly concerned in, or taking steps with a view to, the fraudulent evasion of the tax in question.

HMRC has responded to the consultation on the draft clauses and provided some draft guidance on recommended prevention procedures, covering the six guiding principles of:

- risk assessment
- proportionality of prevention procedures
- top level commitment
- due diligence
- communication (including training)
- monitoring and review

A copy of the draft guidance can be found here.

Supreme Court finds in favour of Ingenious Media Holdings and confirms that HMRC should not have "leaked" confidential information to the press

The Supreme Court has unanimously allowed Ingenious Media's judicial review against HMRC for disclosing information to the Times newspaper.

The Court ruled that previous HMRC chief and permanent secretary, Dave Hartnett, acted unlawfully when he disclosed confidential information to two journalists in an "off the record" briefing. The Court rejected the defence that Mr Hartnett did not expect his comments to be reported.

A copy of the judgment can be found here.

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HMRC to issue fines in bid to stop exploitation of freelancers

A new specialist team has been created within HMRC to tackle the exploitation of freelance workers employed on a "full time" basis at businesses in the UK.

The team will examine and, if necessary, fine businesses with a view to deterring them from using freelancers in full time roles without the associated benefits, in order to obtain a tax advantage.

Businesses found in breach of existing laws may be fined up to 100% of the tax they would otherwise have owed.

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Case reports

Stan Murray-Hession: Tribunal allows taxpayer's share loss relief claim

In *Stan Murray-Hession v HMRC*[1], the First-tier Tribunal (FTT) has held that Mr Murray-Hession (the Appellant) had subscribed for shares within the meaning of section 135(2), Income Tax Act 2007 (ITA), so that share loss relief, under section 131, ITA, was available.

Background

Geezer Telecom Limited (the Company) was a private company limited by shares. It carried on the business of selling phone and broadband services and its sole director was Mr Alan Gray.

On incorporation, the share capital of the Company consisted of 100 ordinary shares of £1 per share paid up. Mr Gray was the sole subscriber for those shares.

The Appellant became acquainted with Mr Gray and in 2010 it became apparent that the Company required further capital. Although the Appellant was not an experienced investor, he was aware that others in his friendship group were investing in the Company and after some negotiation agreed with Mr Gray in early 2011 that he would receive a 22.5% stake in the ordinary share capital of the Company in return for an investment of £272,000.

The Appellant received an email from Mr Gray setting out their agreement and confirming that in return for his investment, the Appellant would receive a subscription of 225 shares "which will come from a new issue of ordinary shares". The Appellant claimed that he had received a share certificate but was unable to produce this to HMRC.

On 13 July 2011, Mr Gray (in his capacity as sole director of the Company) resolved to subdivide the share capital of the Company from 100 nominal shares at £1 to 1,000 shares at 10p.

The Company entered administration in 2012, and the Appellant claimed that he was entitled to loss relief in relation to his investment in the Company, as the shares had become worthless.

HMRC accepted that the Appellant had made payments to the Company between June 2011 and May 2012 to the value of £272,000, but rejected his claim that the Company had issued shares to him. HMRC contended that the share capital of the Company had been subdivided into 1,000 10p shares. This allowed Mr Gray, in July 2011, to transfer 225 shares to the Appellant for nil consideration and in May 2012, the Appellant transferred those shares to Mr Gray for nil consideration. As a result, argued HMRC, the Appellant must have lent the money to the Company. Accordingly, as the Appellant had paid nothing for the shares and received nothing for them when he sold them, he was not entitled to claim share loss relief when the Company entered administration.

The Appellant appealed against the conclusions set out in HMRC's closure notice and the consequential amendments to his return for the tax year 2011/12.

FTT's decision

The sole question for the FTT's determination was whether the Appellant had subscribed for shares in the Company within the meaning of section 135(2), ITA.

1. [2016] UKFTT 612.

The FTT concluded that the Appellant had indeed entered into an agreement with Mr Gray under which he would invest £272,000 in the business by way of subscription for shares. This explained why the funds had been paid to the Company rather than to Mr Gray's personal account, and why the draft accounts of the Company, which had been prepared by a qualified accountant, showed a share premium account.

Further, a letter dated 12 July 2012, from Mr Gray to the Appellant, read as follows:

"Dear Shareholder

... the total cash impact into Geezer is £800,000. I remain & continue to be majority shareholder & CEO of the company. .... There will be a dilution of shares as in all expansions like this. You will receive your new share allocation shortly. This won't impact the value of your return & may look like you have more shares because the amount may go up."

The FTT concluded that the share subdivision had therefore taken place to enable the agreed percentage of shares to be issued to the Appellant and Mr Gray had held the relevant shares as nominee for the Appellant pending their registration. As the Appellant had held the beneficial ownership in the shares from the time of the subdivision, there had been no transfer of beneficial ownership between Mr Gray and the Appellant. The Appellant had therefore "subscribed for shares ... in consideration of money or money's worth" within the meaning of section 135(2), ITA, and had realised a loss for CGT purposes.

The appeal was therefore allowed.

Comment

This decision highlights the importance of ensuring that transactions which may have fiscal consequences are fully documented. Indeed, this appeal may have been avoided had the Appellant been able to evidence to HMRC's satisfaction that the transactions had taken place.

A copy of the decision can be found here.

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Stephen West: Tribunal rejects HMRC's attempt to transfer PAYE liability to employee

In *Stephen West v HMRC*[2], the First-tier Tribunal (FTT) allowed the taxpayer's appeal and confirmed that under the PAYE system the obligation to pay income tax fell on the employer, and liability will only be transferred to the employee under the Income Tax (Pay As You Earn) Regulations 2003, if he has received his remuneration knowing that his employer has wilfully and deliberately failed to deduct PAYE.

Background

Stephen West (the Appellant) was the sole director and shareholder of Astral Telecom Ltd (Astral). He drew money from Astral for a number of years and the drawings were recorded in the director's loan account as loans. At the end of the year a small remuneration and large dividend were approved and credited to the loan account extinguishing the loan. Corporation tax was paid on Astral's profits and income tax was paid by the Appellant through self-assessment. The director's loans were outstanding and increased in amount for the years ending 30 April 2007–2010, inclusive.

2. [2016] UKFTT 536 (TC)

In 2011, the Appellant became concerned about the state of Astral's business. He knew that he could be liable for Astral's debts if it traded while insolvent. The Appellant sought the advice of an insolvency practitioner and he was advised to put the company into liquidation and that he would not receive any dividends for that year as there were insufficient profits available. Instead, payment to him would have to be wholly by way of salary.

The Appellant instructed his accountant to prepare accounts for the liquidation proceedings which, after deducting PAYE and NICs, would be sufficient to offset the drawings on the loan account. This "net" remuneration, which was equivalent to the outstanding director's loans of £129,150, would be "grossed up" by a calculated PAYE and NICs liability to arrive at the figure for director's remuneration in the profit and loss account of £202,967. The company's loan to the Appellant would be repaid in full by the "net" remuneration. The PAYE and NICs were shown on the balance sheet as current liabilities, but not paid to HMRC. The Appellant received no further money from the company.

At the creditor's meeting held on 13 September 2011, a resolution was passed for the voluntary winding up of Astral. The Statement of Affairs showed the PAYE and NICs amounts still owing to HMRC as well as corporation tax and VAT.

HMRC opened an enquiry into why Astral had not paid the PAYE liability. The Appellant acknowledged that he had drawn monies from Astral and that the tax and NICs due in respect of these payments had not been paid to HMRC. The Appellant informed HMRC that he was prepared to consider voluntarily paying the amounts to HMRC. The Appellant was invited to settle on the basis that the liability would be the outstanding amount of the loan account rather than the director's remuneration in the draft management accounts. The Appellant did not respond to this offer and in October 2013, in the absence of a response from the Appellant, HMRC issued separate income tax and NIC decisions[3] for the years 2010/11 and 2011/12, formally transferring the PAYE liabilities from Astral to the Appellant on the basis that he had knowingly received payments from the company on which it had "wilfully" failed to deduct tax.

The Appellant appealed the decisions.

FTT's decision

Before the FTT, the Appellant argued that under the general principles of PAYE the obligation fell on the employer and that this general rule was only set aside in limited circumstances where:

- the employer did not deduct PAYE
- the failure was wilful and deliberate, and
- the employee received the remuneration knowing that the employer had wilfully failed to deduct the tax.

HMRC had to show that all three circumstances were present in order to succeed.

HRMC confirmed that it now accepted that the monies drawn by the Appellant were loans and not payments on account of remuneration. There was therefore no failure to operate PAYE when the payments were made, as had been suggested by HMRC in earlier correspondence. However, HMRC argued that the retrospective grossing up of the director's remuneration to cancel the Appellant's indebtedness to Astral did not constitute the proper operation of PAYE. It relied on *R v CIR, ex parte McVeigh*[4], in which it was held that book-keeping entries without the

3. Under regulation 72 of the Income Tax (Pay As You Earn) Regulations 2003 SI 2003/2682 and regulation 86 of the Social Security (Contributions) Regulations 2001 SI 2001/1004, respectively.
4. [1996] STC 91.

concomitant payment of tax and NICs to HRMC do not constitute the operation of PAYE. HMRC also argued that this was a "paper exercise" with the aim of clearing the Appellant's overdraft loan account and to prevent liquidators recovering the debt from him personally.

It was argued that the Appellant, as the sole shareholder of Astral, had been fully aware of the action taken by his accountant in preparing the draft management accounts and accordingly there was a rebuttable presumption that the determinations had been validly made and the Appellant had failed to rebut this presumption.

The FTT was formed of Judge John Clark and Sandi O'Neil.

Judge Clark agreed with the Appellant that the PAYE was deducted and therefore the first precondition to the operation of regulation 72 was not fulfilled. Judge Clark was satisfied that the relevant net sum sufficient to discharge the loan account was credited to that account in the company's books. The judge said that there was a difference between deducting tax and paying it. The accounts showed deductions for tax and NICs from the payment to the Appellant. As all three preconditions needed to be satisfied in order to justify the transfer of liability to the Appellant, the judge did not need to consider the other two preconditions.

In the view of the judge, the liability could not be shifted to the Appellant and he would therefore allow the appeal.

The other member of the panel, Sandi O'Neill, disagreed with Judge Clark's conclusion. In her view, it was clear from the accounts that the PAYE and NICs deductions were notional and had no substance in reality. Ms O'Neill considered that as the Appellant was the company's "controlling mind" and his knowledge was its knowledge, by creating obligations which the company knew it could not meet, it had wilfully failed to discharge those obligations and had done so in the knowledge of the taxpayer. Accordingly, the Appellant had wilfully failed to discharge those obligations and she would have dismissed the appeal.

As Judge Clark had the casting vote, the Appellant's appeal was allowed.

Comment

Given the dissenting view of Ms O'Neil and the concerns that she expressed that the decision might enable owner managers of small businesses that are about to go into liquidation to make preferential payments to themselves at the expense of creditors such as HMRC, it would not be surprising if HMRC seek to appeal this decision to the Upper Tribunal.

A copy of the decision can be found here.

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Eden Consulting Services: Tribunal has no jurisdiction to consider HMRC's duty to act fairly in administering its statutory powers

In *Eden Consulting Services (Richmond) Ltd v HMRC*[5], the First-tier Tribunal (FTT) determined, as a preliminary issue, that it did not have jurisdiction to consider HMRC's alleged conduct, behaviour and abuse of its powers in determining an appeal against unauthorised payment charges and that such issues are properly for judicial review proceedings and/or the HMRC Adjudicator.

5. [2016] UKFTT 656 (TC).

Background

Eden Consulting Services (Richmond) Limited (the Appellant) was the sponsoring employer of a pension scheme. It appealed against HMRC's decision to assess two unauthorised payment charges under sections 208 and 209, Finance Act 2004. The alleged charges arose from two loans made by an approved occupational pension scheme to the Appellant in 2007 and 2009.

The Appellant argued that the charges did not arise under the legislation and also made several complaints regarding HMRC's abuse of its powers, inappropriate behaviour and unfair conduct.

The FTT considered, as a preliminary issue, whether it had jurisdiction to consider the Appellant's complaints regarding HMRC's conduct.

In summary, the Appellant's complaints were that:

- HMRC failed to provide a copy of its notes from an initial meeting with the Appellant
- HMRC ignored the Appellant's request for a further meeting prior to HMRC issuing the assessments
- HMRC ignored the Appellant's representative resulting in him being unable to properly assist and/or advise the Appellant. Examples included HMRC not copying the Appellant's representative into emails and/or not returning his telephone calls
- When a meeting was finally arranged, HMRC "brushed over" why they had ignored the Appellant's requests for a meeting prior to HMRC issuing the assessments, and
- HMRC failed to provide copies of all documents in relation to a pension scheme as agreed at the CMC and was therefore withholding documents that may undermine its case or advance the case of the Appellant.

The Appellant argued that as the cases of *Hok Limited v HMRC*[6], *Rowland v HMRC*[7] and *Pacific Computers Limited v HMRC*[8] all concerned similar issues which were determined by the FTT and as it was out of time to seek a remedy by means of judicial review proceedings, its complaints should be determined by the FTT.

FTT's decision

The FTT confirmed that although it has no general "supervisory" jurisdiction to consider a taxpayer's claims based on public law concepts such as fairness or inappropriate conduct by HMRC, it does not necessarily mean that public law rights can never be within the jurisdiction of the FTT. As stated in *Simon Newell v HMRC*[9]:

"While … the absence of a supervisory jurisdiction does not preclude public law rights being considered or given effect to [the passage at [31] of *HMRC v Abdul-Noor*[10]] makes it clear that whether that can happen or not depends on the statutory construction of the provision conferring jurisdiction".

In the present case, the assessments were issued pursuant to section 29(1), Taxes Management Act 1970, (TMA) and the jurisdiction of the FTT is set out in section 50(6), TMA. The FTT commented that as a matter of construction, the relevant provisions do not confer on it any public law rights of the type sought by the Appellant. Although section 29(1) does provide that HMRC "may" make an assessment, and in determining the amount to be assessed the legislation refers to HMRC's opinion, *Hok* makes clear that the FTT does not have jurisdiction over the duty of a public body, such as HMRC, to act fairly in administering its statutory powers and therefore matters relating to its conduct fall outside the jurisdiction of the FTT. The FTT

6. [2011] TC 1286.
7. [2006] STC (SCD) 548.
8. [2015] UKFTT 0026 (TC).
9. [2015] UKFTT 0535 at [97].
10. [2013] UKUT 71 (TCC).

commented that none of the allegations made by the Appellant in relation to HMRC's conduct related to the statutory requirements governing the raising of the assessments, or the HMRC review process under sections 49A-49I, TMA. Further, the FTT confirmed that the provision of documents relevant to an appeal is a matter properly dealt with by case management directions issued by the FTT, with the potential sanctions for failure to comply in a timely fashion as set out in the Tribunal Rules, rather than being dealt with as a preliminary issue.

The FTT concluded that the arguments raised by the Appellant regarding HMRC's alleged abuse of its powers, inappropriate behaviour and unfair conduct, fell outside its jurisdiction and are properly for judicial review proceedings and/or the HMRC Adjudicator.

The Appellant's arguments were therefore struck out by the FTT, pursuant to Rule 8(2)(a) of the Tribunal Rules. The FTT directed that the remainder of the Appellant's appeal, relating to whether the unauthorised payments charges properly arise under Finance Act 2004, should proceed.

Comment

Judicial review is the main way the courts supervise bodies exercising public functions, such as HMRC, to ensure that they have acted lawfully and fairly. It is often a difficult decision for a taxpayer to decide whether he should pursue an appeal before the FTT or seek to commence judicial review proceedings in the High Court. In some cases, as appears to have been the case here, a taxpayer will have an issue that falls within the jurisdiction of the FTT, such as his liability to tax and another issue which should be determined by way of judicial review, such as whether HMRC has abused its powers. In such circumstances, the taxpayer may wish to make a "protective" application for judicial review at the outset as the claim form must be filed with the court "promptly" and "in any event within three months after the grounds to make the claim first arose". If appropriate, the judicial review proceedings could then be stayed pending the outcome of the appeal proceedings before the FTT.

A copy of the decision can be found here.

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16641

Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

12 Marina Boulevard
#38-04 Marina Bay Financial Centre Tower 3
Singapore 018982
T +65 6422 3000

RPC