Tax update

February 2017

In this update we report on the government's response to its consultation on non-domicile tax reforms, HMRC's technical note and summary of responses to the recent consultation on tackling disguised remuneration and a new consultation which seeks views on a proposal which would require intermediaries involved in creating, or promoting off-shore structures, to notify HMRC of those arrangements. We also comment on three recent cases involving HMRC's unsuccessful attempt to rely upon section 114, Taxes Management Act 1970, to cure its mistakes, an "income" versus "capital" dispute in the context of rental property and the granting of an injunction prohibiting HMRC from commencing enforcement action for alleged tax liabilities.

News items

HM Treasury publishes response to further consultation on non-domicile tax reforms

The government has responded to the consultation concerning proposed reforms to the taxation of non-domiciles in the UK. The stated aim of the proposed reforms is to introduce a more equal tax treatment of long-term UK resident non-domiciles, prevent non-domiciles from holding UK property indirectly, and also to incentivise inward investment into UK businesses. more›

HMRC publishes technical note and summary of responses to consultation on tackling disguised remuneration

The original consultation included, amongst other things, proposals to tackle tax planning arrangements used by self-employed individuals and in particular to prevent employer deductions where disguised remuneration schemes have been utilised. more›

Tackling tax evasion: proposed new requirement to notify HMRC of offshore structures

A new HMRC consultation seeks views on a proposal to require intermediaries (whether advisors, agents, or businesses) creating or promoting certain complex offshore financial arrangements, to notify HMRC of those arrangements and to provide a list of clients using them. more›

Any comments or queries

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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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Case reports

Cartridge Developments: Tribunal refuses to allow HMRC to rely upon section 114 TMA to cure its mistakes

In *Chartridge Developments Limited v Revenue and Customs Commissioners* [2016] UKFTT 766, the First-tier Tribunal (FTT) allowed (in part) the taxpayer's appeal against penalties imposed for late filing of annual tax on enveloped dwellings (ATED) returns under section 161(3), Finance Act 2013, and refused to allow HMRC to rely upon section 114 Taxes Management Act 1970 (TMA). more›

James Allan Thornton: Tribunal finds for the taxpayer in "income" versus "capital" dispute

In *James Allan Thornton v HMRC* [2016] UKFTT 767 (TC), the FTT considered the distinction between income and capital payments in the context of a settlement relating to rental property and held that a settlement payment made to a landlord as compensation for dilapidations to his property was a capital receipt. more›

Biffin: Court grants injunction against HMRC preventing it from taking enforcement action

In *Biffin Limited and Others v HMRC* [2016] EWHC 2926 (Admin), the High Court granted an injunction against HMRC prohibiting it from commencing enforcement action in respect of certain alleged tax liabilities. more›

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HM Treasury publishes response to further consultation on non-domicile tax reforms

The government has responded to the consultation concerning proposed reforms to the taxation of non-domiciles in the UK. The stated aim of the proposed reforms is to introduce a more equal tax treatment of long-term UK resident non-domiciles, prevent non-domiciles from holding UK property indirectly, and also to incentivise inward investment into UK businesses.

A copy of the Treasury's response paper can be found here.

HMRC publishes technical note and summary of responses to consultation on tackling disguised remuneration

The original consultation included, amongst other things, proposals to tackle tax planning arrangements used by self-employed individuals and in particular to prevent employer deductions where disguised remuneration schemes have been utilised. HMRC has now published its technical overview, which highlights amendments and additions to the original proposals.

A copy of HMRC's technical note and summary of responses can be found here.

Tackling tax evasion: proposed new requirement to notify HMRC of offshore structures

A new HMRC consultation seeks views on a proposal to require intermediaries (whether advisors, agents, or businesses) creating or promoting certain complex offshore financial arrangements, to notify HMRC of those arrangements and to provide a list of clients using them. The consultation will be of interest to both intermediaries and individuals who use such arrangements.

Comments must be received by 27 February 2017.

A copy of the consultation document can be found here.

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Background

ATED provides for an annual charge on UK residential properties over a certain value, which are held by companies, partnerships or collective investment schemes.

Chartridge Developments Limited (Chartridge) is a property development company. As it owns UK residential property, it is within the charge to ATED. However, one of the exemptions from ATED is where the property is held by a property development company.

Chartridge did not submit ATED returns for the period ending 31 March 2014 and 31 March 2015, until 7 August 2015, which was after the due dates for filing the ATED returns.

HMRC was of the view that Chartridge had been careless in failing to submit returns on time and therefore charged late filing penalties pursuant to Schedule 55, Finance Act 2009 (Schedule 55). Schedule 55 provides for an automatic fixed penalty and a discretionary daily penalty for returns filed more than 3 months after the filing date. If a taxpayer is liable to a penalty, HMRC must assess and notify the penalty. The penalty notice must state the period of assessment for the penalty and in the case of daily penalties, the start date (which must be at least three months from the filing date).

Chartridge appealed against the penalties on the following grounds:

- the penalty notices were defective as they referred to incorrect dates
- it had a reasonable excuse for filing the returns late
- HMRC should have allowed a reduction for special circumstances.

The penalties in four of the five penalty notices issued were based on incorrect filing dates (due to HMRC misunderstanding the ATED transitional provisions). This affected the start dates for the daily penalties.

HMRC accepted that some of the dates in the penalty notices were incorrect, however, it argued that the penalty notices were saved by section 114(1), TMA, which provides, in summary, that an assessment or determination shall not be invalidated by reason of a mistake as long as it still conforms to the relevant Taxes Act in substance and effect and if the person intended to be charged understands it.

FTT's decision

In relation to the validity of the penalty notices, the FTT held that while minor calculation errors in penalty notices could be cured by section 114, TMA, provided the filing date was correctly stated, errors in penalty notices caused by incorrect filing dates could not. In the view of the FTT, this was a gross error which was likely to mislead the taxpayer. With regard to these invalid penalty notices, Chartridge's appeal was allowed.

This left one valid penalty notice and the issue was whether Chartridge's reliance on its accountant had constituted a reasonable excuse for the purposes of paragraph 23(1), Schedule 55. The FTT noted that paragraph 23(2)(b) made it clear that reliance on another person could not be a reasonable excuse unless the taxpayer had taken reasonable care to avoid the failure. Chartridge had not established that it had taken such reasonable care. The FTT also found that there were no special circumstances justifying a reduction of the penalty. In particular, the fact that ATED was a new tax did not constitute a special circumstance, since Chartridge accepted that it had known about its obligations. Chartridge's appeal in relation to the one valid notice was dismissed.

Comment

Readers of our weekly tax blog will recall that in July 2016, we discussed the FTT's decision in *Mabbutt v HMRC* [2016] UK FTT 0306 (TC) (a copy of our blog can be found here). In that case, HMRC unsuccessfully attempted to rely upon section 114, TMA to cure a defect in a notice of intention to enquire which it had issued to the taxpayer concerned.

This case provides further guidance and analysis on the scope of section 114 and the types of mistakes by HMRC which the section is capable of curing.

A copy of the decision can be found here.

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James Allan Thornton: Tribunal finds for the taxpayer in "income" versus "capital" dispute

In *James Allan Thornton v HMRC* [2016] UKFTT 767 (TC), the FTT considered the distinction between income and capital payments in the context of a settlement relating to rental property and held that a settlement payment made to a landlord as compensation for dilapidations to his property was a capital receipt.

Background

James Allan Thornton (the taxpayer) was a sole trader who owned 18 flats, known as Jordan House (the property). The property had been the subject of a single lease. Payments in respect of the lease were paid into the taxpayer's bank account for his personal benefit.

The lease contained clauses concerning the repair and upkeep of the property for which responsibility lay with the tenants. However, the tenants had failed in their obligations and the property had become uninhabitable and, according to the taxpayer, "dangerous".

Although the tenants continued to pay rent under the terms of the lease, the property had been vacant for over a year and the taxpayer became anxious to regain possession to enable him to prevent the further dilapidation of the property. He therefore began negotiations with the tenants.

Following assessment by surveyors, the taxpayer sought a settlement payment in excess of £300,000 to reflect both the dilapidations and also a payment referable to a discounted rate of rent.

The sum eventually agreed was £250,000. There was no particularisation of this sum, it was, so the taxpayer argued, a compromise intended to bring the matter to a close.

The taxpayer used the money he had obtained to repair the building. The sum expended on the renovations far exceeded the £250,000 he had obtained in settlement and at the time of the tribunal hearing the repairs were ongoing. It was only after ten months or so that some of the flats were in a fit state to let, with a further section of the property let some 18 months later.

The dispute between HMRC and the taxpayer concerned the treatment of the £250,000 settlement sum. The taxpayer treated the £250,000 as a capital payment which he used to repair the property and thereby safeguard his capital investment.

HMRC argued that the settlement was income because it covered the loss of rental income and issued a discovery assessment to the taxpayer (pursuant to section 29, TMA) on that basis. The taxpayer appealed to the FTT.

FTT's decision

In allowing the taxpayer's appeal, the FTT considered not only the background of the lease, from which HMRC derived its argument that the full sum of settlement must have been attributable to rental payments and must therefore be income, but also the circumstances surrounding the negotiations. In particular, the FTT noted the taxpayer's wish to regain possession of the property as soon as possible and that this had led him to accept a significant reduction in the settlement which was ultimately agreed.

The FTT was of the view that the taxpayer had, in effect, agreed to forgo rental payments when agreeing the final settlement sum. Accordingly, the FTT found that the whole of the settlement related to the costs of repairing the dilapidations and should be treated as capital rather than an income receipt.

Comment

A considerable body of case law has built up on the difficult question of when a payment constitutes an income or capital receipt, particularly in the context of settlement payments.

Each case will of course turn on its own individual facts, but parties in settlement negotiations should pay close attention to the precise nature of the terms of any settlement reached, which should be carefully documented so that in the event of a challenge by HMRC to the nature of the settlement payment, sufficient contemporaneous documentary evidence is available to substantiate the true nature of the payment.

A copy of the decision can be found here.

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Biffin: Court grants injunction against HMRC preventing it from taking enforcement action

In *Biffin Limited and Others v HMRC* [2016] EWHC 2926 (Admin), the High Court granted an injunction against HMRC prohibiting it from commencing enforcement action in respect of certain alleged tax liabilities.

Background

Mr Taylor and Mr McFarane (the Claimants) are the directors and ultimate owners of Biffin Limited.

The underlying dispute concerned the tax consequences of certain property transactions, with the sum in dispute being in excess of £10m. HMRC issued discovery assessments, which were appealed and an application for postponement of the disputed tax was made by the Claimants.

The Claimants brought proceedings by way of judicial review of a number of HMRC's decisions, including amendments to their tax returns and its refusal to agree the postponement of the tax demanded.

The Claimants applied to the High Court for an interim injunction preventing HMRC from commencing enforcement action against them in respect of the alleged tax liabilities that were the subject of the appeal and postponement applications which were before the FTT.

High Court decision
In assessing whether HMRC should be prevented from taking enforcement action in relation to the disputed amounts, the Court considered the well-established principles laid down by Lord Diplock in *American Cyanamid Co v Ethicon Limited* [1975] AC 396, namely:

- is there a serious case to be tried?
- are damages an adequate remedy for the claimant?
- where does the "balance of convenience" lie?

In relation to the first principle, HMRC submitted that the claim for judicial review was "misconceived" because there were alternative remedies available to the Claimants and in any event their claim was without merit.

In disagreeing with HMRC, the Court said:

"… there are mechanisms within the tax legislation for individuals (the Taxes Management Act 1970) and companies (the Finance Act 1998) to challenge the decisions that have been made by the Defendant. However, those mechanisms do not enable the Defendant [sic] to challenge the decision-making process on the grounds of rationality, reasonableness or unlawfulness as the Tax Tribunal does not have the jurisdiction to deal with such challenges."

The Court was of the view that there was a "serious issue to be tried" and the Claimants' claim was not without merit.

In relation to the second principle, the Court was of the view that damages would not be an adequate remedy in the event that HMRC took steps to enforce the alleged tax because of the adverse effect enforcement would have on the company's business. The judge said that enforcement of the disputed tax would cause such hardship to the Claimants that damages would not be an adequate remedy. His view was reinforced by the fact that the only prejudice to HMRC in granting an injunction would be a delay in collecting the amounts in issue should it ultimately be successful in relation to the underlying dispute and any such delay could be adequately compensated by the payment of interest and penalties.

In addressing the third principle, the Court said:

"The disadvantage for the Defendant is that, in the event that they successfully rebut this application for judicial review, there will have been a delay in recovering tax. As I have indicated above, this can be remedied by interest and any penalties. However, the disadvantage for the

Claimants is in my view far more significant, as I have indicated already. There are consequences that cannot be put right after the event and in my view, when all the circumstances of the case are considered, the balance of convenience is in favour of granting the injunction and maintaining the status quo."

The Court therefore concluded that the "balance of convenience" lay in favour of the Claimants and granted an injunction prohibiting HMRC from commencing enforcement action.

Comment

HMRC have a tendency to seek payment of disputed amounts and often resist interim relief where its decisions are under challenge by way of judicial review.

The Court's view in this case was that the only prejudice that HMRC would suffer as a result of granting an injunction would be a delay in the collection of monies should it ultimately be successful. However, any such delay can be adequately compensated for by the payment of interest and, where appropriate, penalties. This is in contrast to many taxpayers who would suffer extreme hardship beyond the scope of pecuniary compensation should HMRC take enforcement action in respect of the sums in dispute.

A copy of the judgment can be found here.

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About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 79 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

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