Tax update

August 2019

In this month's update we report on (1) HMRC's summary of responses to its 'protecting your taxes in insolvency' consultation; (2) HMRC's policy paper on the misuse of company insolvencies; and (3) HMRC's new guidance on loan relationships and derivatives regime anti-avoidance rules. We also comment on three recent cases relating to (1) costs awarded against HMRC due to its unreasonable conduct; (2) procedural unfairness by the FTT; and (3) the quashing of follower and accelerated payment notices in judicial review proceedings.

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HMRC publishes summary of responses to its "protecting your taxes in insolvency" consultation

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HMRC publishes policy paper on the misuse of company insolvencies

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HMRC guidance on loan relationships and derivatives regime anti-avoidance rules

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Ritchie – FTT guilty of procedural unfairness

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Any comments or queries

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About this update

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

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Haworth – Court of Appeal confirms HMRC misdirected itself and quashes follower and accelerated payment notices

The recent judgment of the Court of Appeal in *R (on the application of Haworth) v HMRC* [2019] EWCA Civ 747, is the first successful judicial review challenge against follower and accelerated payment notices. The decision throws into question the way in which the relevant statutory provisions, contained in Finance Act 2014 (FA 2014), relating to follower and accelerated payment notices have been interpreted and operated by HMRC and as a consequence many other notices may have also been issued unlawfully by HMRC. **more›**

News items

HMRC publishes summary of responses to its "protecting your taxes in insolvency" consultation

On 11 July 2019, HMRC published its summary of responses to its "protecting your taxes in insolvency" consultation.

Following the consultation, the government will legislate in the Finance Bill 2019-20 to make HMRC a secondary preferential creditor for certain tax debts paid by employees and taxpayers. This change is intended to ensure that when a business enters insolvency, more of the taxes paid in good faith by employees and taxpayers go to the Exchequer, rather than being distributed to other creditors. Draft legislation and an explanatory note is also available.

The summary of responses can be viewed here.

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HMRC publishes policy paper on the misuse of company insolvencies

On 11 July 2019, HMRC published a policy paper discussing measures which are aimed at those taxpayers who "unfairly seek to reduce their tax bill by misusing the insolvency of companies". This will be achieved by making directors and other persons connected to those companies jointly and severally liable for the avoidance, evasion or "phoenixism" debts of the corporate entity.

An explanatory note and draft legislation set out the conditions that must be satisfied in order to enable an authorised HMRC officer to issue a "joint liability notice" to an individual.

The legislation, in Finance Bill 2019, provides for a person to be jointly and severally liable for amounts payable to HMRC by a company in certain circumstances involving insolvency, or potential insolvency, where that person is a director or shadow director, or connected to the company. The legislation sets out five conditions that must be met where an authorised HMRC officer may issue a "joint liability notice" to an individual. The conditions are that:

1. the company is subject to an insolvency procedure, or there is a serious risk that it will be
2. the company has engaged in tax avoidance or evasion
3. the person was responsible for the company's conduct, enabled or facilitated it, or benefited from it
4. there is likely to be a tax liability arising from the avoidance or evasion
5. there is a serious possibility some or all of that liability will not be paid.

The legislation also sets out the three conditions that need to apply in repeated insolvency and non-payment cases for a notice to be issued. They are that:

1. two or more companies to which the person has a connection have become insolvent in a period of five years
2. the person is connected to another company which carries on the business of the insolvent companies
3. the old companies became insolvent with a liability to HMRC.

For those engaged in the facilitation of tax avoidance or evasion, the conditions are that:

1. a relevant facilitation penalty has been charged, or proceedings to charge one have begun
2. the company is subject to an insolvency procedure, or there is a serious risk that it will be
3. there is a serious possibility some or all of the penalty will not be paid.

Tax avoidance arrangements and tax evasion conduct are defined by reference to relevant existing legislation.

There is provision for an individual to appeal against a notice.

The policy paper can be viewed here.

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HMRC guidance on loan relationships and derivatives regime anti-avoidance rules

On 26 June 2019, HMRC added paragraphs CFM39500 to CFM39590 to its Corporate Finance Manual, containing guidance on the loan relationships and derivatives regime anti-avoidance rules (RAARs).

The guidance notes that the question of purposes is one of fact, based on all the available evidence. The purposes are those of the arrangements, not the parties individually, and a tax purpose of one party may bring the arrangements within the RAARs for all. Transactions should not be assessed individually; the overall arrangements should be considered.

Arrangements can have multiple main purposes, so a main purpose is not necessarily the most important. HMRC appears to consider "main purpose" as being synonymous with "significant objective". Incidental benefits are not main purposes but HMRC considers that any benefit that is more than incidental is likely to constitute a main purpose. Tax reductions are not necessarily main purposes simply because they feature in structuring decisions and choosing the most tax efficient, of several options, to achieve a commercial goal is permissible. However, in HMRC's view, subsidiarity of tax value to commercial benefit does not preclude "main purpose" status. The fundamental question is whether a tax benefit is more than incidental.

Generally, specific anti-avoidance provisions should be applied before the RAARs, except for the "unallowable purpose" rules. However, these rules are wider as they extend beyond loan relationships and derivative debits and credits, and do not consider underlying principles. HMRC provides several examples of how the RAARs might apply in various scenarios (including interaction with the "unallowable purpose" rules).

The examples are helpful but are only indicative. As HMRC stresses, the fact-dependent application of the RAARs cannot be determined through generic indicators, so the RAARs may remain difficult to apply in practice.

The manual can be viewed here.

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Case reports

Mr E – HMRC's unreasonable conduct leads to costs award against it

In *Mr E v HMRC* [2018] UKFTT 771 (TC), the First-tier Tribunal (FTT) has held that HMRC acted unreasonably in not withdrawing an information notice earlier than it did and awarded the taxpayer his costs.

Background

On 4 July 2017, HMRC issued to Mr E (the taxpayer) a notice pursuant to paragraph 1, Schedule 36, Finance Act 2008 (the information notice) requesting certain documents.

On 22 December 2017, the taxpayer appealed the information notice to the FTT.

On 23 January 2018, HMRC wrote to the taxpayer advising him that it intended to issue third party notices pursuant to paragraph 2, Schedule 36, Finance Act 2008, to various banks in relation to his tax affairs. HMRC also issued the taxpayer with a penalty notice in respect of his failure to provide the material requested by the information notice.

On 26 January 2018, the taxpayer wrote to HMRC informing it that the information notice was subject to an appeal in the FTT and inviting HMRC to withdraw both the penalty and information notice.

On 5 March 2018, after further correspondence between the parties, HMRC gave notice of its intention to withdraw the information notice as it no longer considered the information notice to be sustainable. HMRC did this despite no new arguments or evidence having been received by it since receipt of the taxpayer's letter of 26 January 2018.

On 7 March 2018, the FTT confirmed its receipt of HMRC's notification of withdrawal and allowed the taxpayer's appeal.

The taxpayer subsequently applied for his costs under Rule 10(1)(b), Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Tribunal Rules), on the basis that HMRC had acted unreasonably in 'bringing, conducting or defending proceedings' within the meaning of that rule.

FTT decision

The application was granted.

At the beginning of the hearing, the taxpayer successfully applied, under Rule 32 of the Tribunal Rules, for the hearing to be conducted in private and for the decision to be anonymised. HMRC did not object to that application which was granted by the FTT.

With regard to the issue of costs, the FTT considered that the questions to be asked in determining whether HMRC had acted unreasonably were:

1. what was HMRC's reason for withdrawing from the appeal
2. could HMRC have withdrawn at an earlier stage, and
3. was it unreasonable for HMRC not to have withdrawn at an earlier stage.

1. What was HMRC's reason for withdrawing from the appeal?
HMRC had decided that, upon examining the arguments presented on the taxpayer's behalf, the information notice was unsustainable. There was no evidence that any of the arguments or evidence produced on the taxpayer's behalf were provided in his notice of appeal or after proceedings had begun. All such evidence and arguments were available to HMRC at the commencement of the appeal proceedings.

2. Could HMRC have withdrawn earlier?
The FTT concluded that the earliest HMRC could have withdrawn was upon receipt of the taxpayer's letter of 26 January 2018, informing it of his appeal to the FTT. Prior to this, HMRC was unaware that the taxpayer had commenced proceedings in the FTT and so it could not have withdrawn.

3. Was the failure to withdraw unreasonable?
As there was no evidence that HMRC's decision to withdraw the information notice on 5 March 2018 was based on new arguments or evidence, the FTT decided that it was unreasonable for HMRC to not have withdrawn the information notice after receipt of the taxpayer's letter of 26 January2018.

In the view of the FTT, some internal consideration would have been needed upon receipt by HMRC of the taxpayer's letter of 26 January 2018 and the FTT therefore decided that 2 February 2018 was the earliest date on which HMRC should have withdrawn the information notice if it had been acting reasonably. Accordingly, the FTT awarded the taxpayer his costs from this date.

Comment
This decision provides some helpful guidance on determining the earliest date from when a taxpayer can recover his costs from HMRC when it has acted unreasonably in 'bringing, conducting or defending proceedings', within the meaning of rule 10(1)(b) of the Tribunal Rules.

Where HMRC has acted unreasonably, a taxpayer is entitled to the costs he has incurred during the period HMRC acted unreasonably. In the view of the FTT, it is not the case that once it has been established that a party has acted unreasonably in conducting the proceedings, the award should extend to all of the costs incurred by the other party which were of, or incidental to, the proceedings, including those not incurred as a result of the unreasonable conduct. The award should be limited to the costs incurred in consequence of the unreasonable conduct. Therefore, in this instance, the taxpayer was not entitled to his costs incurred before 2 February 2018.

The decision can be viewed here.

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Ritchie – FTT guilty of procedural unfairness

In *Ritchie v HMRC* [2019] UKUT 007 (TCC), the Upper Tribunal (UT) has held that the FTT erred in finding that a loss of tax had been brought about by carelessness on the part of the taxpayers' professional advisers because, amongst other things, the carelessness of the advisers had not been adequately pleaded by HMRC and had not been put to any of the witnesses in cross-examination.

Background

In January 2007, Mr and Mrs Ritchie (the taxpayers) sold a plot of land on which was a house they had built, together with other buildings.

The taxpayers sought advice from their accountant as to the tax consequences of the disposal. Their accountant referred them to a former tax inspector for advice. After meeting with the latter, the taxpayers reported back to their accountant that there was no CGT liability arising from the sale and the accountant completed the taxpayers' tax returns for the year of disposal without referring to the sale and reported no chargeable gain.

On 12 March 2013 and 27 March 2013, HMRC issued 'discovery' assessments under section 29, Taxes Management Act 1970 (TMA) to the taxpayers, assessing each of them to CGT on a chargeable gain from the sale of the land (the assessments). The assessments were made on the basis that the gain which arose on the sale of the land was not wholly exempt under the principal private residence provisions contained in section 222, Taxation of Chargeable Gains Act 1992 (TCGA) (the PPR provisions).

The taxpayers appealed against the assessments. The following two issues were before the FTT:

1. to what extent was the gain on the sale of the land exempt from CGT under the PPR provisions, and
2. were the conditions in section 29, TMA, for the making of a discovery assessment and the time limit provisions in section 36, TMA, satisfied, in particular, was the loss of tax counteracted by the assessments due to the carelessness of the taxpayers or a person acting on their behalf?

FTT decision

The taxpayers argued that the gain on the disposal of the land was exempt under the PPR provisions and that the assessments had been issued outside the normal four-year time limit provided for in section 34, TMA. HMRC argued that the gain was not exempt and that the loss of tax had been brought about by the taxpayers' carelessness and that therefore the time limit for making an assessment was extended to six years under section 36, TMA.

It was not until its closing submissions before the FTT that HMRC argued that it was the taxpayers' professional advisers who had been careless, rather than the taxpayers themselves.

The FTT found that a larger part of the gain on the disposal of the land was exempted under the PPR provisions than had been allowed by HMRC and that the provisions of sections 29 and 36, TMA, were satisfied by reason of the carelessness, not of the taxpayers, but of their professional advisers. It reduced the chargeable gain significantly, but upheld the making of the assessments.

HMRC appealed to the UT against the FTT's findings in relation to the effect of the PPR provisions. The taxpayers appealed against the FTT's findings that the carelessness condition was satisfied.

UT decision

The taxpayers' appeal was allowed.

The UT first heard argument on the carelessness issue and concluded that the FTT had erred in law in finding that the carelessness condition was satisfied. Given its conclusion on this issue, it did not need to hear any argument on the PPR issue.

In reaching its conclusion, the UT considered whether the FTT had been correct to conclude that the professional advisers' carelessness had been adequately pleaded.

In its statement of case and skeleton argument, HMRC had not clearly indicated it was intending to argue that the assessments could be justified due to carelessness on the part of the professional advisers. The emphasis was on the carelessness of the taxpayers and the single reference to "advisor" did not unequivocally suggest that the advisers were acting on behalf of the taxpayers and that their actions could trigger section 36(1B), TMA.

The UT also concluded that there was nothing in the previous correspondence between the parties that could cast those statements in a wider light.

It was reasonable for the taxpayers' to have understood HMRC's case to be premised on their carelessness. The FTT's conclusion that the issue had been adequately pleaded was not one reasonably open to it.

The UT then considered whether the FTT had given the taxpayers an opportunity to deal with the issue of the advisers' carelessness.

The UT held that the FTT's right to investigate matters which had not been put in issue by the parties was subject to the requirements of fairness. In the instant case, it was unfair for the point to have been raised after the close of evidence without consideration of whether the taxpayers should be given an opportunity to adduce further evidence. The suggestion that the advisers had been careless, or that their carelessness had caused the loss of tax, had not been put to them.

Although an allegation of carelessness was not as serious as an allegation of fraud, which had to be put clearly and expressly to a witness, the UT noted that there were three reasons why it should be made clear to the witness at some stage during his examination that carelessness was being alleged. The first was to alert the other party to the argument; the second was that if the witness was unclear that his conduct was at issue, he might fail to mention issues relevant to it; and the third was out of fairness to the witness.

The UT said that a tribunal should not find a witness to have been careless without giving him an opportunity to explain his actions or contest the allegation, especially so if the professional competency of the witness was being questioned. It was not necessary to consider what re-examination might have added to the evidence; the witnesses had concluded their evidence before the allegation was articulated, and the taxpayers were deprived of an opportunity of exploring the issue with them.

In light of its conclusions that the FTT had erred in upholding the assessments on the basis of carelessness on the part of the professional advisers, the UT considered whether it should remit the matter back to the FTT. The UT decided that it should not remit the appeal back to the FTT. Although there is a public interest in the correct amount of tax being collected, there was also a competing public interest in litigation being brought to a conclusion. The matter dated back many years and the hearing before the FTT was the opportunity for the parties to call their evidence and put their case. The question of any carelessness on the part of the advisers had not been put squarely before the FTT and it was now too late. In the view of the UT, it would be unfair for that question to be revived.

Comment

Although litigation before the FTT is less formal than litigation before the higher courts, certain rules of evidence and of natural justice must be followed. This decision provides helpful confirmation of the rules of evidence and the requirement for a party, including HMRC, to plead its case properly.

Rule 25 of the Tribunal Rules provides that HMRC must deliver a statement of case which sets out the legislative provisions under which an appealed decision was made and its position in relation to the appeal. As the UT noted, whilst an allegation of carelessness was not as serious as an allegation of fraud, it still had to be properly pleaded and tested in evidence. HMRC had failed to properly particularise its case in this regard and the FTT had erred in law in reaching conclusions based on untested allegations.

The decision can be viewed here.

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Haworth – Court of Appeal confirms HMRC misdirected itself and quashes follower and accelerated payment notices

The recent judgment of the Court of Appeal in *R (on the application of Haworth) v HMRC* [2019] EWCA Civ 747, is the first successful judicial review challenge against follower and accelerated payment notices. The decision throws into question the way in which the relevant statutory provisions, contained in Finance Act 2014 (FA 2014), relating to follower and accelerated payment notices have been interpreted and operated by HMRC and as a consequence many other notices may have also been issued unlawfully by HMRC.

This report is based on an article first published in Taxation on 18 June 2019. A copy of that article can be found here.

The legislation

Section 204, FA 2014, enables HMRC to issue a follower notice to a taxpayer requiring the taxpayer to take 'corrective action' to relinquish a particular 'tax advantage' arising out of that taxpayer's chosen tax arrangements. A taxpayer who fails to take such corrective action can be liable to a penalty of up to 50% of the understated tax. On the issue of a follower notice, section 219, FA 2014, enables HMRC to issue an accelerated payment notice requiring the taxpayer to pay the disputed tax to HMRC before the dispute has been determined on appeal, or by way of agreement.

In order for a follower notice or accelerated payment notice to be issued, the following conditions must be satisfied:

A. a tax enquiry must be in progress into a return or claim made by the taxpayer in relation to a relevant tax, or the taxpayer must have made an appeal in relation to a relevant tax which has not been determined, abandoned, or otherwise disposed of (sections 204(2) and 219(2), FA 2014)

B. the return or claim or, as the case may be, appeal, must be made on the basis that a particular tax advantage (the asserted advantage) results from particular tax arrangements (the chosen arrangements) (sections 204(3) and 219(3), FA 2014).

In order for a follower notice to be issued, the following additional conditions must be satisfied:

C. HMRC must be of the opinion that there is a "judicial ruling" which is relevant to the chosen arrangements (section 204(4), FA 2014), and

D. no previous follower notice must have been given to the same person (and not withdrawn) by reference to the same tax advantage, tax arrangements, judicial ruling and tax period (section 204(5), FA 2014).

A "judicial ruling" is a ruling of a court or tribunal on one or more issues and is "relevant to the chosen arrangements" if:

- it relates to tax arrangements,
- the principles laid down, or reasoning given, in the ruling would, if applied to the chosen arrangements, deny the asserted advantage or a part of that advantage, and
- it is a final ruling (section 205(3), FA 2014).

In order for an accelerated payment notice to be issued, condition C in section 219(4), FA 2014, must also be met, which means the tax arrangements in question must be disclosable to HMRC under the disclosure of tax avoidance schemes regime referred to in FA 2004, or HMRC must have issued a follower notice to the taxpayer in respect of the same arrangements.

Background

Mr Haworth had established a trust to hold shares for his benefit and that of his family. The trustees were resident in Jersey. When he considered the disposal of the shares in 2000, he replaced the Jersey trustees with trustees resident in Mauritius. This was intended to avoid capital gains tax on the disposal of the shares.

Mr Haworth argued that he was not chargeable in respect of the gains made because they were exempted from the charge to UK capital gains tax by virtue of the UK/Mauritius double tax treaty. If, applying the "tie-breaker" provisions under the treaty, the place of effective management of the trust was in Mauritius, not the UK, the gain would be exempt from capital gains tax. There was no Mauritian tax on the gain. This arrangement is commonly referred to as the 'Round the World' tax avoidance scheme.

In *Smallwood v HMRC* [2010] EWCA Civ 778, the Court of Appeal held that a trust whose trustee was a Mauritian resident company was actually managed and controlled from the UK and not Mauritius so double taxation did not apply. Accordingly, an arrangement similar to the one implemented by Mr Haworth failed. Following the *Smallwood* decision, HMRC issued both follower notices and accelerated payment notices to a large number of taxpayers, including Mr Haworth.

As many readers will be aware, there is no right of appeal against a follower notice or an accelerated payment notice and Mr Haworth therefore challenged HMRC's decision by way of judicial review proceedings in the High Court.

The question for determination was whether the "principles laid down, or reasoning given" in *Smallwood* would, if applied to the circumstances of Mr Haworth's case, deny the "asserted advantage".

High Court judgment
Mr Justice Cranston held that *Smallwood* contained both principles and reasoning that were capable of application to similar arrangements implemented by other taxpayers, such as Mr Haworth. In the view of Cranston J, HMRC had correctly applied *Smallwood* to determine whether the trust in Mr Haworth's case was controlled from the UK and if it was, this would deny Mr Haworth his asserted tax advantage.

Mr Justice Cranston also concluded that the follower notice was not defective due to any irregularities in its form and/or the manner in which it was issued.

Mr Haworth appealed to the Court of Appeal.

Court of Appeal judgment
The appeal was allowed.

The appeal gave rise to two principle issues for determination:

1. whether the words "principles laid down, or reasoning given", in section 205(3), refer exclusively to points of law determined in the 'judicial ruling' in question, and
2. whether the word "would", in section 205(3), requires HMRC to be of the opinion that the principles or reasoning in the ruling in the relevant decision would (as opposed to would be more likely than not) deny the asserted advantage.

Issue 1
Mr Haworth argued that section 205(3)(b) refers exclusively to points of law determined in the "judicial ruling" in question and that "reasoning given" was a translation into English of the ratio decidendi, or reason for the decision, which is recognised as the legal basis upon which a case is decided. The Court of Appeal agreed with the High Court that "reasoning given" was an alternative to "principles laid down" and extended beyond legal points.

The Court of Appeal concluded that the inclusion of the words 'or reasoning given' in section 205(3)(b), did not support Mr Haworth's contention. The High Court was therefore correct to hold that 'principles laid down' and 'reasoning given' are separate and alternative concepts. The Court of Appeal noted at para [34]:

"In the circumstances, it seems to me that HMRC are not constrained to have regard only to the ratio of a case, but can also take into account other reasoning to be found in it. Were, say, appellate judges both to conclude that the FTT had been entitled to make a finding of fact and to say that they agreed with it, there could be no doubt but that the latter comment could be material. Of course, though, the fact that an observation did not form part of the ratio could potentially have a bearing on the weight to be attached to it."

The Court of Appeal therefore found in favour of HMRC on the first issue.

Issue 2
With regard to the second issue, HMRC argued that section 205(3)(b) requires no more than for it to consider that the principles or reasoning laid down in the relevant judicial ruling relied upon are more likely than not to result in the asserted advantage being denied.

Mr Haworth submitted that HMRC is required to be of the opinion that the principles or reasoning would deny the asserted advantage, not merely that they would be likely to do so, and that follower notices can only properly be issued if HMRC believes that there is no real prospect of the taxpayer succeeding in his appeal.

The Court of Appeal agreed with Mr Haworth on this issue. It is not enough that HMRC considers that the principles or reasoning in the relevant ruling would be more likely than not to deny the advantage. The word "would" implies that HMRC must be of the opinion that, should the point be tested, the principles or reasoning found in the relevant ruling relied upon **will** deny the asserted advantage. This demands more certainty than simply a perception that there is a more likely than not chance of the advantage being denied. The Court of Appeal noted at para [36(iii)]:

"[HMRC's] construction of section 205(3)(b) would allow follower notices to be given in a surprisingly wide range of cases. There would seem, for example, to be no bar on such a notice being given if HMRC believed there was a 51% chance of a high-level principle found in a decided case (say, the Ramsay approach applied recently in *UBS AG v Revenue and Customs Commissioners* [2016] UKSC 13, [2016] 1 WLR 1005) being held to apply in a quite different factual situation. On this basis, it would theoretically be possible for HMRC to use follower notices routinely in relation to disputes pending before the FTT. After all, HMRC's "Litigation and Settlement Strategy" explains in paragraph 16 that they "will not usually persist with a tax dispute unless it potentially secures the best practicable return for the Exchequer and HMRC has a case which it believes would be successful in litigation."

The Court of Appeal referred to the Explanatory Notes to FA 2014, and the comments relating to follower notices, where it is stated that they are directed at a case where "a tribunal or court has concluded in another party's litigation that **the arrangements** do not produce the asserted tax advantage" (emphasis added). In other words, "the arrangements" must be the same (or materially the same) arrangements as those implemented by the taxpayer to whom the follower notice is to be issued.

The Court of Appeal noted the serious consequences that can flow from the issuance of a follower notice, noting that a recipient is exposed to the risk of having to pay a penalty of up to 50% of the amount at stake plus smaller penalties if he does not comply with an accelerated payment notice and commented at paras [36(iii) and (iv)]:

"I can see no indication that follower notices were meant to be available to HMRC otherwise than in relatively exceptional circumstances ...

Parliament might be expected to have intended such a regime to be applicable only in a limited class of cases".

The Court of Appeal referred to the dicta of the Supreme Court in *R (UNISON) v Lord Chancellor* [2017] UKSC 51, where it was said that "the constitutional right of access to the courts is inherent in the rule of law" and observed at para [36(vi)]:

"impediments to the right of access to the courts can constitute a serious hindrance even if they do not make access completely impossible ...

even where a statutory power authorises an intrusion upon the right of access to the courts, it is interpreted as authorising only such a degree of intrusion as is reasonably necessary to fulfil the objective of the provision in question".

The Court concluded that, as receipt of a follower notice may deter a taxpayer from pursuing his appeal to the First-tier Tribunal, the aforementioned principles provide further reason for interpreting section 205(3)(b) so as to require more than a 51% chance of the principles or reasoning from an earlier decision denying the asserted advantage. In other words, there must be a high degree of certainty that the appeal would fail.

In the view of the Court, it could be inferred that when deciding to approve a follower notice in Mr Haworth's case, HMRC was proceeding on the basis that mere likelihood was sufficient, and did not ask itself whether the "principles laid down or reasoning given" in *Smallwood* would deny Mr Haworth the asserted advantage. This, the Court said, amounted to a misdirection on the law by HMRC.

The Court rejected HMRC's argument that its misdirection could be saved because HMRC could (although it did not) rationally conclude that the principles or reasoning in Smallwood would deny Mr Haworth the asserted tax advantage.

The follower notice and accompanying accelerated payment notice were therefore quashed.

Other deficiencies
The Court of Appeal accepted that the follower notice issued to Mr Haworth was deficient in its form as it had failed to explain why Smallwood made Mr Haworth's case futile and did not provide sufficient detail on the way in which the principles or reasoning in Smallwood would defeat his appeal. However, on the facts, including lack of prejudice to Mr Haworth, the Court did not consider that the follower notice would be rendered invalid because of these deficiencies.

Comment
The principles relied upon by the Court of Appeal in dismissing HMRC's arguments are important in protecting the rights of the citizen against the executive authority of the State and maintaining the rule of law. The powers in question were described by the Court as "draconian", and as Lord Justice Gross stated in his judgment in support of Lord Justice Newey's leading judgment, these powers should be "carefully circumscribed, not least ... because of their impact on access to the courts and the rule of law".

The decision has implications for other taxpayers who have received follower notices in recent years. For example, following the Supreme Court's decision in *RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club Plc) v Advocate General for Scotland* [2017] UKSC 45 (the *Rangers* case), HMRC issued a large number of follower notices to taxpayers who had participated in employee benefit type arrangements. Whilst some of these arrangements may have been similar to the arrangements considered in the *Rangers* case, not all of them were materially the same as the arrangements considered in *Rangers*. In light of the Court of Appeal's decision in *Haworth*, some of those follower notices may have been issued invalidly.

Going forward, HMRC should not issue a follower notice to a taxpayer simply because it considers that the principles or reasoning in the relevant judicial decision it relies upon would be likely to deny the tax advantage in that taxpayer's case. The Court of Appeal has confirmed that HMRC must have a "substantial degree of confidence" that the taxpayer's appeal would fail. In practice, this should mean that a follower notice is only issued when the same, or materially the same, arrangements have been entered into by the taxpayer who is to receive the follower notice.

With regard to existing follower notices, if a taxpayer has received a follower notice which relies on a judicial decision in which the underlying arrangements are not the same as those in which the taxpayer participated, consideration should be given to whether HMRC should be invited to withdraw the follower notice and any accompanying accelerated payment notice.

Given the significance of this decision, it would not be surprising if HMRC was to seek permission to appeal to the Supreme Court.

The judgment can be viewed here.

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- Shortlisted – Best Copyright Team – Managing IP Awards 2019
- Shortlisted – Insurance Team of the Year – Legal Business Awards 2018
- Winner – Best Employer – Bristol Pride Gala Awards 2018
- Winner – Client Service Innovation Award – The Lawyer Awards 2017
- Shortlisted – Corporate Team of the Year – The Lawyer Awards 2017
- Winner – Adviser of the Year – Insurance Day (London Market Awards) 2017
- Winner – Best Tax Team in a Law Firm – Taxation Awards 2017
- Winner – Claims Legal Services Provider of the Year – Claims Club Asia Awards 2016

Areas of expertise

- Advertising & Marketing
- Alternative Dispute Resolution
- Commercial Contracts
- Commercial Litigation
- Competition
- Corporate Crime & Investigations
- Corporate
- Data & Technology
- Employment & Pensions
- Financial Markets Litigation
- Health, Safety & Environmental
- Insurance & Reinsurance
- Intellectual Property
- International Arbitration
- Private Equity & Finance
- Product Liability & Regulation
- Real Estate
- Regulatory
- Restructuring & Insolvency
- Tax
- Trusts, Wealth & Private Client

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