TOP 10 CASES FOR THE FIRST 6 MONTHS OF 2015

Tax Journal

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Tax Journal's top 10 cases for the first 6 months of 2015 – and 5 on reasonable excuse…

Produced by Tax Journal

1. *Eclipse*: was a partnership carrying on a trade?

In *Eclipse Film Partners No. 35 v HMRC* [2015] EWCA Civ 95 (17 February 2015), the Court of Appeal found that Eclipse 35 had not been trading.

Eclipse 35, a partnership, and its members had entered into a complex series of transactions for the acquisition, distribution and marketing of film rights.

The members had borrowed money to contribute to the capital of the partnership. They could only claim tax relief in respect of the interest if the loan was used wholly for the purpose of a trade carried on by Eclipse 35 (ITTOIA 2005 s 863 and ICTA 1988 ss 353, 362).

The FTT had found that Eclipse 35 had not played 'a meaningful part in the marketing and distribution of the films'; it had therefore not carried on a trade. The FTT's decision had been upheld by the UT.

The Court of Appeal noted that the transactions had two aspects. One aspect was that a payment by Eclipse 35 of £503m would be repaid with interest over a 20 year term and would produce a profit unrelated to the success of the exploitation of film rights. That aspect had the character of an investment. The second aspect was the possibility for Eclipse 35 to obtain a share of 'contingent receipts'. The court accepted the FTT's finding that the possibility of receiving such receipts was too remote for this aspect to be significant.

Finally, the court rejected the contention that the activity of entering into a licence and sub-licence inherently constituted the carrying on of a trade.

Why it matters: Like the tax tribunals, the Court of Appeal accepted that the transactions were not 'shams'. However, this finding did not prevent the court from holding that 'on a realistic view of the facts' (applying the *Ramsay* doctrine), Eclipse 35 had acquired an investment rather than carried on a trade.

Tax Journal's coverage: 'The court has confirmed that in assessing whether an activity amounts to a trade, it is necessary to consider the totality of what is done. The court has indicated that the concept of trade has a variety of meanings or shades of meaning.' See the article 'The Court of Appeal judgment in *Eclipse*' (Chris Bates and Judy Harrison) *Tax Journal*, 13 March 2015.

2. *European Commission v UK*: UK rules on cross-border group relief comply with EU law

In ***European Commission v UK*** (C-172/13) (3 February 2015), the CJEU found that the UK legislation on cross-border group relief complies with EU law principles.

The European Commission was applying for a declaration by the CJEU that CTA 2010 s 119(4) makes it virtually impossible in practice to obtain cross-border group relief, so that the UK has failed to fulfil its obligations under TFEU arts 31 and 49.

Cross-border group relief is only available if the 'no possibilities test' is satisfied; that is, if the losses are not relievable in the country where the loss-making subsidiary is established. Under CTA 2010 s 119(4), the determination as to whether losses may be taken into account in the future must be made 'as at the time immediately after the end' of the accounting period in which the losses were sustained. According to the Commission, cross-border relief can therefore only be available if either carry forward of losses is not possible under the legislation of the country of residence of the subsidiary; or if the subsidiary is liquidated at that time.

However, the CJEU observed that the first situation mentioned by the Commission was irrelevant for the purpose of assessing the proportionality of s 119(4). In such a situation, the member state in which the parent company is resident may not allow cross-border group relief without thereby infringing art 49 (*K* C-322/11). As for the second situation, the CJEU considered that s 119(4) does not require the subsidiary to be put into liquidation before the end of the accounting period in which the losses were sustained. The provision only imposes a requirement to make an 'assessment' at that time.

The Commission also submitted that the UK was in breach of TFEU arts 49 and 31 in that its legislation precludes cross-border group relief for losses sustained before 1 April 2006. The CJEU found, however, that the Commission had not established the existence of situations in which cross-border group relief for losses sustained before 1 April 2006 was not granted.

The CJEU therefore rejected both complaints.

Why it matters: By confirming that the UK legislation on cross-border group relief is now compliant with the EU law principles of freedom of establishment and of movement of capital, the CJEU's decision may have come as a disappointment to some international groups.

Tax Journal's coverage: 'HMRC may argue that [this judgment] prevents all cross-border group relief claims, except for foreign losses which were evidently – immediately after the end of the accounting period – unusable. This judgment does limit claims for time expired losses. It will also at least delay settlement of claims for terminal losses where it only became evident at a later stage that the losses were terminal. But that part of the judgment is arguably narrow and may not do what HMRC will hope.' See the article 'The CJEU on the UK's group relief rules and EU law' (Rupert Shiers) *Tax Journal*, 13 February 2015.

3. *Healey*: discount on stripped coupon security

In ***Malcolm Healey v HMRC*** [2015] UKUT 140 (25 March 2015), the UT found that a discount on a stripped coupon security was of an income nature.

Mr Healey had purchased commercial securities issued by a bank and from which the interest coupons had been stripped. The price paid by Mr Healey was lower, to reflect the low return on the coupons. The interest coupons were later reattached to the notes, which Mr Healey then sold on the market for their full market price. This provided him with an after-tax return much higher than on a fixed-term deposit.

It was accepted that Mr Healey had acquired the notes at a discount 'in the normal commercial sense of the term'. The issue was whether the discount was of an income nature (chargeable under ICTA 1988 Sch D Case III). The UT found that the discount was clearly not intended to compensate Mr Healey for any capital risk, as the issuer had a high credit rating. Clearly, the purpose of the discount was to compensate Mr Healey for the absence of interest. The position was essentially the same as it would have been if Mr Healey had bought a non-interest bearing note issued at a discount. From Mr Healey's perspective, it was immaterial that interest was payable to a third party.

The UT stressed, however, that the fact that the transaction was marketed as a way of providing an enhanced after-tax return was not relevant when ascertaining the tax position.

Why it matters: The UT focused on the acquisition of the notes at a discount, rather than on their disposal at a profit. The discount was of an income nature as it compensated for the absence of interest. The UT also dismissed the taxpayer's appeal in *Savva and others v HMRC* [2015] UKUT 141, which turned on similar facts. The scheme would not have achieved its intended result today, as income tax returns which are economically equivalent to interest are charged under FA 2013 s 12.

Tax Journal's coverage: 'HMRC has won three separate anti-avoidance cases in the UT against a scheme promoted by NT Advisors (see *Healey v HMRC* [2015] UKUT 0140 (TCC); *Savva v HMRC* [2015] UKUT 0141 (TCC); and *Steve Price, John Myers and James Lucas v HMRC* [2013] UKFTT 297 (TC)). These latest cases are further evidence, should it be needed, of HMRC's approach to tax avoidance schemes and the judiciary's view of attempts by taxpayers to characterise taxable income returns as exempt capital gains.' See the article 'Private client briefing for April' (Andrew Goldstone and Sarah Albury), *Tax Journal*, 17 April 2015.

4. *Colaingrove*: reduced rate of VAT and complex supplies

In ***HMRC v Colaingrove*** [2015] UKUT 80 (10 March 2015), the UT found that the reduced rate could not apply to an element of a complex supply to which the standard rate applied.

Colaingrove provided serviced chalets and static caravans at holiday parks. The issue was whether the provision of electricity by Colaingrove to holiday makers should be taxed at a reduced rate of VAT (under VATA 1994 Sch 7A Group 1), notwithstanding that the charge for electricity was an element of a single complex supply of serviced accommodation taxed at the standard rate.

Colaingrove contended that UK domestic legislation, on its true construction, provided for a reduced rate to apply to the supply of electricity, where that supply formed a concrete and separate part of a wider supply. It therefore fell to the UT to decide whether the exemptions, as enacted in the UK, fell within the ambit of the derogation permitted by EU law.

The UT wondered why Parliament would only give a tax break to those holiday makers that received their electricity by means of a single supply. It considered, however, that Parliament may have wanted to draw a distinction between the provision of electricity in a verifiable amount and the provision of a fixed charge irrespective of use. Agreeing with *AN Checker* [2013] UKFTT 506, the UT concluded that the 'stumbling block' was the combined effect of the *Card Protection Plan* (*CPP*) (C-349/96) line and the provision in VATA 1994 s 29A that a

reduced rate of VAT may only be charged on a 'supply that is of a description for the time being specified in Schedule 7A'. Neither *French Undertakers* (C-94/09) nor *Talacre* (C-251/05) 'trumped' the CPP analysis. The supply was not a supply specified in Sch 7A; and s 29A applied only to the single complex supply and not to elements of that supply.

Why it matters: Since *French Undertakers* and *Talacre*, many have wrestled with the notion that elements of a complex standard rated supply may be taxable at a reduced rate. This case suggests that those decisions were of limited application, so that most complex supplies should be charged at a single rate. In finding as it did, the UT recognised that its decision would have undesirable results when seen from the point of view of the recipients of the supply.

Tax Journal's coverage: 'The analysis of the interaction between French Undertakers and the CPP line of cases, and the domestic reduced rating provisions, will provide useful guidance for taxpayers more generally when determining whether reduced VAT rates could apply in the context of single composite supplies involving non-reduced rated elements. Hildyard J expressed some sympathy for the taxpayer's arguments, and so an appeal to the Court of Appeal seems likely.' See the article 'VAT briefing for April' (Lee Squires and Fiona Bantock), *Tax Journal*, 10 April 2015

5. *Samarkand*: film partnerships and loss relief

In ***Samarkand Film Partnership No. 3, Proteus Film Partnership and three partners v HMRC*** [2015] UKUT 211 (29 April), the UT found that the partners were not entitled to loss relief and that they had not had a legitimate expectation that the relief would be available.

The issue was whether two partnerships, which had acquired and leased films under sale and leaseback arrangements, were entitled to loss relief in respect of losses which arose on the acquisition of the films. If so, their partners could claim sideways relief under ICTA 1988 ss 380 and 381 to set the losses against their taxable income from other sources.

The purchase of an asset which a person intends to exploit over a period of time is normally treated as capital expenditure. However, ITTOIA 2005 s 134 provides that in the case of a film, the expenditure should be regarded as revenue in nature. Furthermore, ss 138 and 140 allow loss relief to be claimed in advance of the normal rules. Relief is not available, though, if the expenses are not incurred wholly and exclusively for the purposes of a trade or if the losses are not connected with or arising out of a trade.

The UT found that the FTT had been entitled to conclude that the partnerships had not been carrying on a trade, so that no loss relief was available to the partners. This was so, even though a transaction of that type could have constituted a trade. In particular, it accepted the FTT's factual finding that the commercial nature of the agreements was 'the payment of a lump sum in return for a series of fixed payments over 15 years'.

No further arguments were required following the release of the Court of Appeal's decision in *Eclipse Film Partners* [2015] EWCA Civ 95, which recommended a 'realistic approach to the transaction'. The UT added that even if the partnerships had been conducting a trade, they would not have been doing so on a commercial basis, as the transactions were intended to produce a loss in net present value terms. This analysis was not affected by the fact that the

individual partners were accruing 'extra benefits' as a result of the tax reliefs. Those reliefs were obtained by 'deliberately causing the partnership to trade in an uncommercial manner'.

The two judges disagreed as to whether, in any event, one of the partnerships had incurred the expenditure for the acquisition of a film (as opposed to that of an income stream). The president exercised its casting vote on this issue, finding that the partnership had incurred the expenditure for the purchase of a film. This was because it had acted bona fide in the belief that it was acquiring valuable rights.

The taxpayers also claimed judicial review on the ground that HMRC's denial of relief was at odds with its own published guidance in HMRC's *Business Income Manual* (BIM). The UT pointed out that unlike *IR20*, which was aimed to give taxpayers guidance on residence, the BIM was intended for the use of HMRC staff – although it was made available to the public. The UT observed that the BIM stressed in several places that the relief was aimed at tax deferral only.

Furthermore, the BIM included clear statements that transactions involving tax avoidance would be closely scrutinised and that the guidance may not be applied to them. The argument that this statement suggested that HMRC reserved the right to treat similar transactions differently was robustly rejected. 'Taxpayers may not like that statement but they could not say that they derived a legitimate expectation that was at odds with it.' Finally, the UT found that HMRC had reasonably thought that tax avoidance was at play. Several features indicated that the aim of the transactions was not tax deferment but tax avoidance.

Why it matters: The appeal failed on both the 'trading issue' and the legitimate expectation issue. On the trading issue, the UT simply reiterated the points made by the FTT on the basis of its factual findings. On the legitimate expectation issue, the taxpayers could not rely on HMRC's description of a plain vanilla transaction (claiming that their arrangements were similar) and ignore the general statement about tax avoidance. They could not 'take out the plums they liked and ignore the duff they did not'.

Tax Journal coverage: 'The decision in *Samarkand* serves as a timely reminder to taxpayers of the extent to which they can rely on HMRC's manuals. The decision highlights that no matter how clear or unqualified a statement in HMRC's manuals might appear to be, it will be open for HMRC to depart from that guidance if it considers that tax avoidance is or may be involved, leaving the taxpayer in question with an uphill struggle to prove that it has a substantive legitimate expectation that should be protected.' See the article '*Samarkand*: illegitimate expectations?' (Jeanette Zaman & Owen Williams) *Tax Journal*, 22 May 2015.

6. *Pendragon*: VAT abuse

In *Pendragon and others v HMRC* [2015] UKSC 37 (10 June), the Supreme Court, reversing the decision of the Court of Appeal, found that a scheme designed by KPMG to avoid VAT on the resale of demonstrator cars was abusive.

The object of the scheme was to ensure that companies in a car distributor group were able to recover input tax incurred on the price of new cars acquired as demonstrator cars, while avoiding the payment of output tax on the sale of these cars to consumers. The issue was whether it was abusive under the *Halifax* principle.

The KPMG scheme involved the sale by the distributors of newly acquired cars to captive leasing companies (CLCs); the leasing of the cars by the CLCs to the distributor's dealerships; the assignments of the leasing agreements and titles to the cars to a Jersey bank (SGJ); the sale by SGJ of its hire business as a transfer of a going concern (TOGC) to a company of the distributor group (Captive Co 5); and, finally, the sale of the cars by Captive Co 5 to customers.

The success of the scheme relied primarily on the VAT (Cars) Order, SI 1992/3122, art 8, which provides that dealers in second-hand goods are allowed to charge VAT not on the whole consideration for the sale of the goods, but on their profit margin only.

The Supreme Court thus observed that the effect of the KPMG scheme was to enable the Pendragon Group to sell demonstrator cars second hand under the margin scheme, in circumstances where VAT had not only been previously charged but fully recovered, so 'that no net charge to VAT was ever suffered, except on the small or non-existent profits realised on the resale'. The Supreme Court concluded that a system designed to prevent double taxation on the consideration for goods had been exploited so as to prevent any taxation on the consideration at all. The first limb of the *Halifax* test was therefore satisfied; the scheme was contrary to the purpose of the legislation.

As for the second limb, the Supreme Court found that the transaction had the essential aim of obtaining a tax advantage. Two steps had been inserted which had had no commercial rationale other than the achievement of a tax advantage. The first one was the leasing of the cars by the CLCs to ensure that one of the gateways of art 8 applied: the assignment of rights under a hire purchase or conditional sale agreement. The second one was the acquisition of the business by Captive Co 5, so that the acquisition of the cars was brought within the gateway for assets acquired as part of a business transferred as a going concern.

As the scheme was an abuse of law, it fell to be redefined as a sale and leaseback transaction, followed by a sale to customers to which art 8 did not apply.

Why it matters: The court highlighted two difficulties of the *Halifax* principle. The first arose from the assumption that the principle will not apply to 'normal commercial transactions', as 'the VAT Directives must be assumed to have been designed to accommodate them'. This had led the Court of Appeal to find that the arrangements were not abusive. The second difficulty resulted from concurrent purposes. The question was then whether the commercial objective was enough to explain the particular features of the arrangements.

Tax Journal comment: 'HMRC is likely to take great comfort from *Pendragon* and to attack existing and future VAT planning structures. The continued efficacy of offshore structures, as in *Newey* [2015] UKUT 0300, must be in doubt … One may also expect a degree of mission creep in the willingness of the Upper Tribunal to take an intrusive approach to factual evaluation by the FTT.' See the article 'What's new in VAT abuse?' (Michael Conlon QC and Rebecca Murray) *Tax Journal*, 26 June 2015.

7. *Littlewoods*: compound interest on VAT wrongly paid

In ***Littlewoods Ltd and others v HMRC*** [2015] EWCA Civ 515 (21 May), the Court of Appeal found that Littlewoods was entitled to compound interest on VAT wrongly paid.

Littlewoods had paid VAT which was not due. HMRC had repaid the principal amount together with simple interest. Littlewoods claimed that it was also entitled to compound interest. There were four issues.

First, were Littlewoods' restitution claims excluded by VATA 1994 ss 78 and 80 as a matter of English law and without reference to EU Law? The Court of Appeal found that the net effect of the provisions was that the only cause of action available to the taxpayer for the repayment of the principal sums was that afforded by s 80(1) and so restitutionary claims for repayment of VAT were barred by s 80(7). Furthermore, s 78(1) excluded common law claims for interest.

Second, did the exclusion of the claim by VATA 1994 violate the principle of effectiveness by depriving Littlewoods of an adequate indemnity for the loss occasioned through the undue payment of VAT? The Court of Appeal noted that 'adequate indemnity' was not a rigid 'straitjacket' which required compound interest in every case. However, s 78 did deprive Littlewoods of an adequate indemnity.

Third, ss 78 and 80 could not be construed so as to conform with EU law as the exclusion of common law claims for interest was a cardinal feature of the legislation. The provisions must therefore be disapplied. Furthermore, the Court of Appeal did not have the power to disapply the domestic bar to the enforcement of Littlewoods' rights on a selective basis. The choice of remedy therefore belonged to Littlewoods who chose to make a mistake-based restitution claim as this was not time-barred whereas a *Woolwich* claim would have been time-barred.

Finally, on quantum, HMRC should not be treated as if it were an involuntary recipient of overpayments of tax. 'Objective use value' applied to the valuation of the time value of the overpayments made to HMRC and compound interest was payable. Interest should continue to run after the date of the repayment of the principal amounts of overpaid VAT on such amounts of accrued interest as remained outstanding.

Why it matters: This is the latest instalment of a judicial saga which includes two high court decisions and a preliminary ruling by the CJEU. The tax at stake is colossal: £1.2bn in compound interest.

Tax Journal comment: 'A further appeal to the Supreme Court must be a possibility … and it would be surprising if the court did not grant permission to appeal. A further period of uncertainty is inevitable. In the meantime, businesses and their advisers should:

- ensure proceedings for restitution are commenced within the time limits laid down by the Limitation Act 1990;
- obtain expert evidence on appropriate interest rates, including evidence to rebut HMRC's attempts to reduce the quantum of the claim by arguing for a defendant-focused rate; and
- be prepared to demonstrate why the claim displays "exceptional circumstances", in order to support the case for compound, rather than simple, interest.'

See the article '*Littlewoods Retail*: compound interest claim upheld' (Michael Conlon QC) *Tax Journal*, 5 June 2015.

8. *Southern Cross*: HMRC's ability to enter into binding agreements

In ***HMRC v Southern Cross Employment*** [2015] UKUT 122 (1 April 2015), the UT found that HMRC was bound by a contract with the taxpayer.

HMRC had paid £1.4m to Southern Cross for repayment of VAT and associated interest and now sought to recover it. Southern Cross contended that the repayment had been made under a binding contract.

There were three issues:

(1) Did VATA 1994 s 80 bar HMRC from entering into a binding agreement with Southern Cross?

(2) Would any compromise agreement have been ultra vires and so void?

(3) Was a compromise agreement formed on the facts?

In relation to (1), the UT found that s 80 did not bar HMRC from entering into a binding agreement to settle a claim. The UT referred inter alia to *DFS* [2002] EWHC 807 – which establishes that s 85 allows HMRC to enter into a binding agreement in the context of an appeal – and noted that there was no reason why such ability would not exist in the absence of an appeal.

As for (2), the UT again found in favour of Southern Cross. The fact that it was later established that the supply of dental nurses to dentists was standard rated and not exempt, as agreed by HMRC, did not make the agreement void.

Finally, in relation to (3), the UT found that the pattern of correspondence between HMRC and Southern Cross, viewed objectively, pointed towards a process of negotiation and, in the end, an intention to conclude a contractual agreement. The UT noted in particular the language used by the parties, for instance the use of expressions such as 'offer' and 'accept'.

Why it matters: The case is interesting on two grounds: firstly, it confirms that HMRC can enter into agreements relating to VATA 1994 s 80 repayments; and secondly (and perhaps most importantly), it suggests that such agreements are binding even if the position agreed by HMRC is then judicially found to be wrong.

Tax Journal comment: 'This decision exposes limitations on HMRC's ability to make assessments under s 80(4A), (7). Perhaps most significantly, both tribunals held that the agreement entered into was not ultra vires. At the time the agreement was entered into, HMRC did not make any error of law by entering into the agreement, so it was a reasonable one. It was not ultra vires because it turned out that HMRC had not been liable to repay VAT to Southern Cross ... The case illustrates that there must be merit in closely reviewing whether a compromise agreement has been entered into where a repayment has been agreed by HMRC, if it seeks to reopen it and recover the repayment.' See the article '*Southern Cross*: compromise agreement not ultra vires' (Tarlochan Lall) *Tax Journal*, 17 April 2015.

9. *Dunne*: application for interim relief against a PPN

In ***R (on the application of Dunne) v HMRC*** [2015] EWHC 1204 (31 March 2015), the High Court granted interim relief in relation to partner payment notices (PPNs), in the limited terms accepted by HMRC.

This was an application for interim relief in the context of an application for judicial review which had been brought by the claimants challenging PPNs issued by HMRC. A PPN is an APN (accelerated payment notice) issued to a partnership under FA 2014 Sch 32. The PPN regime confers no statutory right of appeal to a specialist tribunal and the only way to challenge a PPN is to apply for a judicial review – or to rely on the invalidity of the PPN as a defence to any subsequent enforcement decisions.

The High Court expressed doubt as to whether it did have jurisdiction to grant an injunction on the facts of the case, given the mandatory and unambiguous language of the legislation. In any event, relying on CC & C [2014] EWCA Civ 1653, it would not exercise such power as there was no reason for it to interfere with the statutory scheme. The scheme presupposed that HMRC would comply with its statutory duties. Any questions as to whether there was an excuse for the non-payment of penalties should be dealt with by the FTT, if and when HMRC had made a decision on it.

The High Court therefore only granted limited relief in the form of an order that, in the event that the claimants had established hardship, HMRC could not, without first applying to the court, take steps to enforce any sum due and payable under any PPN.

Why it matters: The case follows a similar line to that adopted by the High Court in *Nigel Rowe and others v HMRC* (unreported). Unless a taxpayer can establish hardship, he will have to pay the tax demanded under an APN.

Tax Journal comment: 'As things stand, there does not seem to be a risk free means of avoiding or mitigating the obligation to make payments under an accelerated payment notice. Taxpayers should think carefully before deciding not to make payments under such a notice pending the determination of a challenge to the notice.' See the article 'APNs: can taxpayers avoid the immediate obligation to pay?' (Steve Bousher) *Tax Journal*, 12 June 2015.

10. *Personal representatives of Mr Michael Wood (Deceased)*: protective assessments and the death of the taxpayer

In ***Personal representatives of Mr Michael Wood (Deceased) v HMRC*** [2015] UKFTT 282 (12 June 2015), the FTT found that HMRC could pursue assessments against a taxpayer who had died.

On 2 June 2010, Mr Wood, a dentist, had attempted to make a disclosure under HMRC's 'tax health plan' – a campaign that gave medical professionals an opportunity to tell HMRC about undeclared income by making a voluntary disclosure, in return for reduced penalties. HMRC had considered, however, that the disclosure was not covered by the terms of the Tax Health Plan and had opened a 'COP 9 investigation'. Code of Practice 9 governs cases where fraud is suspected.

Following a meeting with HMRC, Mr Wood had agreed to commission a disclosure report into his tax affairs by September 2011. The report had not been produced and HMRC had issued assessments against which Mr Wood had appealed. He had died on 22 May 2013. Mr Wood's widow, who was his personal representative, contended that she would not be able to contest HMRC's allegations of deliberate behaviour by Mr Wood now that he had died. Therefore, requiring her to contest the disputed assessments would be in breach of the Convention on Human Rights art 6 (right to a fair trial) and would be contrary to the overriding objective of the FTT under Tribunal Procedure Rules (SI 2009/273) rule 2.

The art 6 argument could only succeed if HMRC's disputed assessments amounted to charging Mr Wood with a criminal offence. His widow pointed out that the extended time limit of TMA 1970 s 36(1A)(a), which HMRC relied upon to raise the assessment, required the tax loss to have been 'brought about deliberately'. This she thought, amounted to charging the taxpayer with a criminal offence.

The FTT considered, however, that the effect of s 36(1A)(a) was simply to enable HMRC, upon proof of the deliberate bringing about of a loss of tax, to recover from the taxpayer what he should have paid, so that recourse to the extended assessment time limit was not penal in nature. The effect of the provision was not to condemn or punish. As for rule 2, the FTT found that the best achievement of the overriding objective would be obtained by not setting aside HMRC's assessments. The FTT stressed that the disputed assessments had been raised on a protective basis because the disclosure report had been delayed, and the liabilities under those assessments had crystallised before Mr Wood's death.

Why it matters: The FTT recognised that it was required to apply a very 'blunt tool' to a 'delicate situation'. It also accepted the difficulties of Mr Wood's widow. However, it felt that the litigation must follow its course, starting with the submission of the disclosure report.

And 5 cases on reasonable excuse…

1. Where reliance on accountant was reasonable excuse…

In ***Sudar Shini Mahendran v HMRC*** [2015] UKFTT 278 (9 June 2015), the FTT found that a taxpayer had a reasonable excuse for the late payment of CGT.

Mrs Mahendran had sold a property and the monies to pay the CGT were held by her solicitor. She had submitted an unsolicited return with a liability of £12,544 consisting entirely of CGT. Payment was due by 31 January 2014 but it was not made until the following September; and HMRC had imposed penalties under FA 2009 Sch 56. The issue was whether Mrs Mahendran had a reasonable excuse.

The FTT first dismissed any contentions that her illness had prevented her from managing her tax affairs, given that she had been able to perform her duties as a primary school teacher and that she had been able to instruct accountants.

Referring to *Rowland* [2006] STC (SCD) 536, the FTT found that it had been 'sensible and reasonable' for Mrs Mahendran to rely 'upon persons whom she reasonably believed to have the relevant specialist knowledge and expertise'. The issue, under FA 2009 Sch 56 para

16(1)(b), was therefore whether she had taken 'reasonable care to avoid the failure'. The FTT noted that she had diligently provided her accountants with any information requested and had chased them on several occasions. The FTT added that it had been reasonable for her not to contact HMRC to ask for assistance before the due date, as she thought that matters were being dealt with by her accountants.

Why it matters: This case offers a useful illustration of the way FA 2009 Sch 56 para 16(1)(b) operates. Taxpayers wishing to rely on this provision should ensure that, like Mrs Mahendran, they keep records of communications (or failed communications) with their tax agents.

2. And where reliance on adviser was *not* a reasonable excuse, but penalties could be mitigated

In ***Jaswinder Dhariwal v HMRC*** [2015] UKFTT 0041 (27 January 2015), the FTT found that reliance on an accountant was not a reasonable excuse.

Mr Dhariwal is a dentist who manages several dentistry practices, and his tax affairs were dealt with by Mr Bhamra his accountant. At a meeting in February 2009, Mr Bhamra had indicated to Mr Dhariwal that his return for the previous year had been submitted (albeit late). The return was in fact not submitted until December 2012. Between April 2009 and December 2012, HMRC had written to Mr Dhariwal several times, mentioning that the return was still outstanding and imposing penalties.

Mr Dhariwal contended that he had a reasonable excuse; he had relied on his otherwise trustworthy accountant who had intentionally misled him. Referring to *Rowland* [2006] UKspC 0054, the FTT noted that one of the few circumstances where the failure of a tax agent can amount to a reasonable excuse is when the agent has been providing technical advice. The filing of a tax return was however an 'administrative task' which did not fall into that category. The fact that the accountant also provided more sophisticated tax advice to the taxpayer did not change the fact that the filing of the tax return was a discrete service for which a separate invoice was issued. Furthermore, the penalty notices and determinations should have alerted Mr Dhariwal to the fact that there were issues with his return. Email exchanges also suggested that the taxpayer was starting to doubt the reliability of his accountant.

The FTT found, however, that the fact that the accountant had offered reassurances which had turned out to be false should be taken into account when calculating the penalty, which must therefore be reduced.

Why it matters: The case focuses on the distinction between technical tax advice, reliance on which can be a reasonable excuse, and the failure to carry out administrative tasks by a tax agent which cannot give rise to such a claim. It also suggests that even where reasonable excuse is not established, mitigating circumstances can reduce the penalty. Such circumstances should therefore always be put forward.

3. Agent's late registration by HMRC was a reasonable excuse

In ***Perfect Permit v HMRC*** [2015] UKFTT 171 (23 April 2015), the FTT found that the late registration of an agent by HMRC constituted a reasonable excuse for the late submission of employer annual returns (EAR).

Perfect Permit had delivered its EAR (forms P35 and P14) late in respect of the years 2008/09 and 2009/10 and had been charged penalties.

The FTT observed that the 2008/09 return had been filed on 5 July 2010, over a year late, and so the penalty was due. The failure of the taxpayer's previous agent was not a reasonable excuse and it was up to the taxpayer to seek redress from its agent.

The return for 2009/10 was also filed on 5 July 2010, only 47 days late and by the taxpayer's new agent. The FTT accepted that the new agent had experienced 'genuine and continuing difficulties' in registering with HMRC as an agent. He had started the process on 5 March 2010 and still had not been registered by 5 August 2010. Had HMRC registered the new agent reasonably promptly, it was likely that the return would have been filed on time. HMRC's delay in registering the new agent therefore represented a reasonable excuse.

Why it matters: Like the previous case, this case is a rare example of 'reasonable excuse' being successfully pleaded. It also confirms that a system failure by HMRC can constitute a reasonable excuse.

4. Where IT issues constituted a reasonable excuse

In ***Joanna L Porter t/a Crafty Creations v HMRC*** [2015] UKFTT 0170 (23 April 2015), the FTT found that IT issues constituted had a reasonable excuse for the late filing of a return.

Ms Porter was appealing against a penalty imposed for the late filing of her individual tax return. The due date had been 31 January 2014, but she had filed her return on 5 March 2014.

She had repeatedly contacted HMRC prior to the deadline explaining that she was unable to pay the tax due online due to some access issue; and she had been informed that this was due to an IT failure which would be remedied.

The FTT found that Ms Porter had 'done her best' to submit her return on time. The IT difficulties that she had encountered were unexpected and had eventually been solved when HMRC had issued her with a new ID number. The taxpayer had established a reasonable excuse.

Why it matters: Cases in which a taxpayer successfully establishes a reasonable excuse are few and far between. This case may provide a useful precedent to any taxpayer who files a return late due to IT issues.

5. But ignorance of the law is no reasonable excuse

In ***The Bunker Secure Hosting v HMRC*** [2015] UKFTT 146 (14 April 2015), the FTT found that being unaware of the penalty regime was not a reasonable excuse.

The taxpayer was appealing against penalties for the late payment of PAYE and NICs. It argued that the letter from HMRC imposing the penalties was the first it had received regarding the late payments. It also contended that it had received no generic information from HMRC.

A BillPay statement showed that a payment had been debited from the taxpayer's account on 20 July (the due date for payment). However, such a payment requires activation three days before the due date; and it had therefore reached HMRC late.

The FTT found that the scheme laid down by FA 2009 Sch 56 gave no discretion, the rate of penalty being simply driven by the number of PAYE late payments. Furthermore, the legislation did not require HMRC to issue warnings; and failure to do so by HMRC did not amount to a reasonable excuse or even special circumstances.

The FTT added that it remained unconvinced that the taxpayer had not received any information and that, in any event, ignorance of the law was not a reasonable excuse.

Finally, referring to *Hok* [2012] UKUT 363, the FTT noted that it did not have the power to discharge penalties on the ground of unfairness.

Why it matters: The taxpayer accepted that it was aware of the due date for payment. Therefore, the fact that he was not aware of the penalty regime could not constitute a reasonable excuse.

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