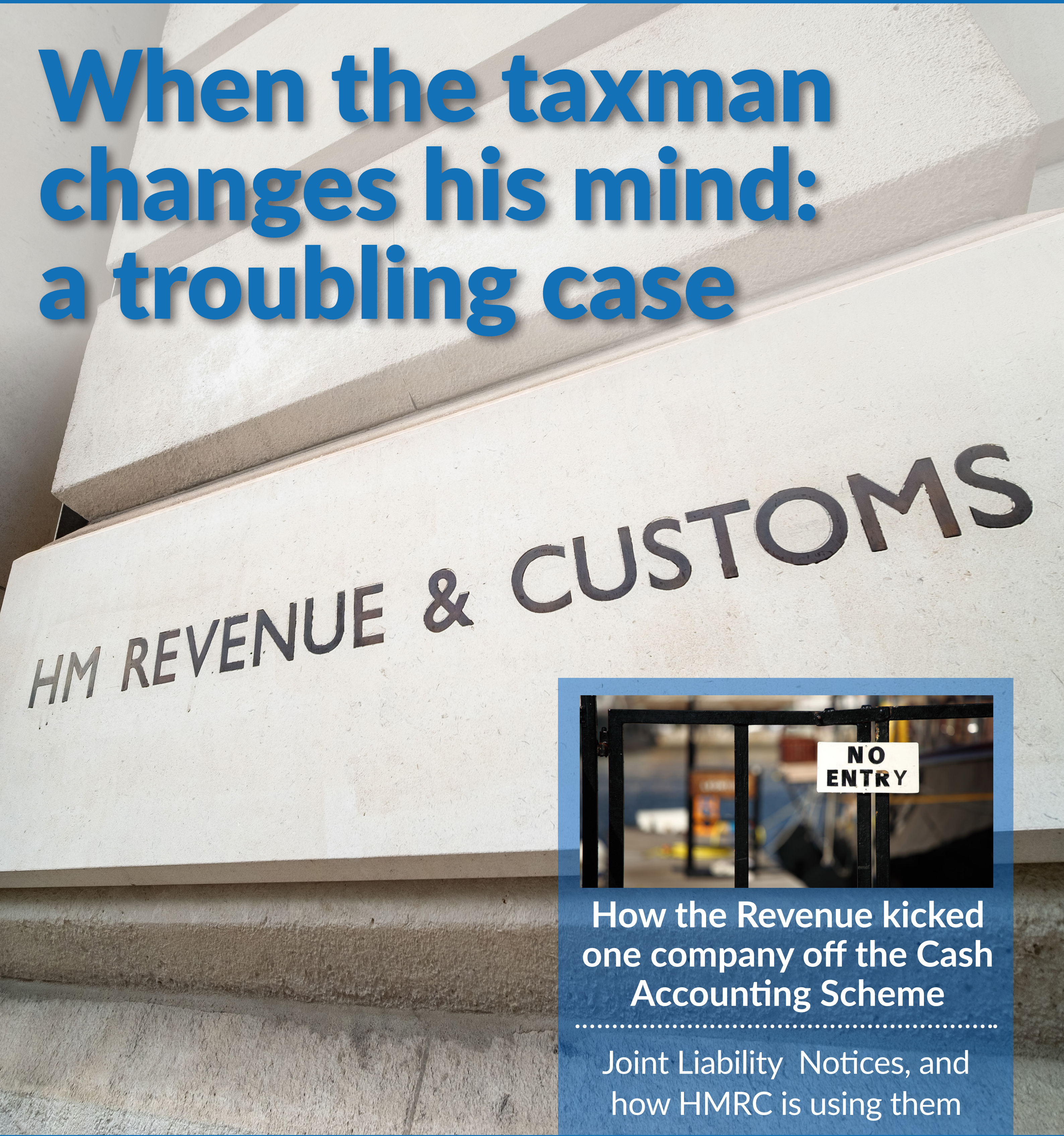
HMRC Enquiries Investigations & Powers

February/March 2021



When the taxman changes his mind: a troubling case

How the Revenue kicked one company off the Cash Accounting Scheme

Joint Liability Notices, and how HMRC is using them

Meet the contributors

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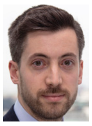

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Case defeats cost HMRC millions in legal costs

HMRC spent more than £2m in legal costs following lost cases in 2019/20, according to research by law firm Pinsent Masons. This represented an 88% hike in the amount HMRC shelled out in legal costs to taxpayers for the period.

In the 2018/19 tax year, the taxman settled 34 cases, costing HMRC some £1.34m. In 2019/20 that had jumped to 43 cases, costing it more than £2.5m.

Pinsent Masons' research found that the jump in court costs awarded suggests that HMRC is pursuing more disputes and more complex issues through the courts system. The data suggests HMRC paid out on average some £58,277 per case in 2019/20, up from £39,014 the year before.

The law firm said the rising average indicates HMRC is losing more complex and drawn-out cases against taxpayers, where legal costs are much higher.

Pinsent Masons partner Steven Porter said: "The rise in the number of cases where taxpayers were awarded costs may suggest HMRC has been too bullish in some of the cases it has chosen to litigate."

The costs incurred by HMRC represent a relatively small proportion of the money it collects through disputes.

Separate research by Pinsent Masons found HMRC is generating greater returns on compliance work. For example, the taxman collected £107 for every £1 spent on staff costs for investigations into the UK's largest businesses last year. It is therefore likely that HMRC will continue to pursue cases through to litigation to increase their yield.

A HMRC spokesperson said: "HMRC litigates in accordance with its obligations as the tax authority, and the Litigation and Settlement Strategy supports the correct discharge of those obligations."

HMRC's Litigation and Settlement Strategy (LSS) is HMRC's internal rules governing its approach to resolving disputes.

The LSS makes it impossible for HMRC to settle an investigation when they believe there is a greater than 50% chance of winning the case. In such circumstances, HMRC will only settle for all of the tax they believe is due. The only way for taxpayers to reduce the amount of tax owed is to dispute it in court.

In 2017, HMRC updated the LSS to reduce the chance of disputes reaching court. However, the length of time it takes for cases to reach tribunal stage means it may be several years until it is clear whether these changes have been effective.

Porter added: "The rigidness of HMRC's settlement strategy means that cases in which both HMRC and the taxpayer feel they have a high chance of winning can't be settled – there is no room for splitting the difference under the LSS."

Welcome

Welcome to the latest issue of the HMRC Enquiries, Investigation and Powers e-magazine.

This issue was published just days after the March Budget, so our schedule precluded any in-depth analysis of what was announced. We will, of course, be covering the important points in our next issue, so let's see what emerges from the small print.

The fact that the government is to invest £100 million in a 'Taxpayer Protection Taskforce' was the headline-grabber for us. According to the Budget Report 2021 "it will employ 1,265 HMRC staff to combat fraud within Covid-19 support packages, including the CJRS and SEISS, representing one of the largest responses to a fraud risk by HMRC". Where these staff come from is just one question that immediately comes to mind; we'll attempt to answer this and many other questions raised next time around (see page 9 for more on this).

In the meantime, many thanks again to all our wonderful contributors.

Happy reading,
The Armstrong Media team

Contents

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Permission denied!

Les Howard highlights a case where HMRC removed a company's permission to use the Cash Accounting Scheme

This is not something we come across every day! Very many small businesses use the Cash Accounting scheme, some without knowing it! Originally, when the scheme was introduced, the taxpayer had to apply to HMRC for permission. Now, of course, there is no requirement to seek permission.

However, the scheme still has a number of conditions. In particular, in relation to the Michael Robinson case, there is a general power of HMRC to exclude someone from the scheme. VAT Regulation 64(1)(d) reads: "A person shall not be entitled to continue to operate the scheme where... the Commissioners consider it necessary for the protection of the revenue that he shall not be so entitled."

Michael Robinson was involved in a number of companies, which were involved in property development. The economic crisis in 2008/09 led to the loss of finance for a £7m residential housing development. This left the companies short of cash. While Mr Robinson sought further funding, invoices raised from one of his companies, *PMR Ltd* to two more of his companies, *Castle Developments Wales Ltd (CDW)* and *Court Estates & Developments Ltd (CED)* were unpaid. However, PMR used Cash Accounting, while CDW and CED used 'normal' accrual accounting. The obvious outcome was that CDW and CED claimed input tax but PMR did not account for the corresponding output tax.

It was not until April 2014 that HMRC opened an investigation into this disparity (the Tribunal decision does not explain the reason for this long delay.) As a result of this investigation and using the 'protection of the revenue' powers, HMRC directed PMR to cease using Cash Accounting.

During the period of investigation, Mr Robinson had been in contact with HMRC, explaining the difficulty in raising finance. So, although the correspondence from HMRC had directed that PMR cease using Cash Accounting after VAT period P02/15, he understood that the communication between himself and HMRC meant that they were granting him a transitional period to put matters in order. The significant of this will become clear later.

The Tribunal explains the repeated issuing and withdrawing of penalties against the company, PMR and against Mr Robinson. I have to say that this is a little confusing. The end result was a personal liability penalty issued against Mr Robinson for around £31,000. This was on the basis that the company's failure to cease using Cash Accounting was deliberate AND that that failure was attributable to Mr Robinson. (Such a penalty cannot be issued if the original error is deemed to be careless. Further, such penalties are frequently issued if HMRC think that the company will become insolvent.)

In his original appeal, one ground was that HMRC were wrong to withdraw use of the Cash Accounting scheme. This was withdrawn before the hearing. I think the company would have lost on that ground, as it does not require proof of deliberate action. HMRC's 'protection of the revenue' power is quite broad.

There is a right of appeal against a decision to withdraw use of Cash Accounting from a taxpayer (s83(1)(y)). HMRC guidance at ARTG3042 states that the Tribunal has only limited jurisdiction on such an appeal. This is because the Commissioners are acting for 'the protection of the revenue'. This broad power was at issue in the previous case of *FPV Ltd & Marketing Middle East Ltd* (VTD 15666). Since the protection of the revenue is a matter for the Commissioners, an appeal cannot be made directly against the use of that power unless the Commissioners can be shown to have acted unreasonably. It also explains why s84 does not refer to s83(1)(y).

The second ground of appeal was whether the company and, by implication, Mr Robinson, had acted deliberately in submitting the Return using Cash Accounting. There is a test in the FTT case of Auxilium Project Management Ltd which is applied: "In our view, a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test. The question is not whether a reasonable taxpayer might have made the same error or even whether this taxpayer failed to take all reasonable steps to ensure that the return was accurate. It is a question of the knowledge and intention of the particular taxpayer at the time."

The Tribunal made a distinction between whether Mr Robinson had a good reason to act as he did, or whether he genuinely believed he had a good reason (see para 61). The Tribunal held that, on this subjective test, Mr Robinson did believe he had been given effective permission to continue to use Cash Accounting at the time. The Appeal was therefore allowed.

Comment

This is one of those case that raise a number of VAT issues:

- There is the basic question of compliance, in this case, with the rules of the Cash Accounting scheme.
- Then there is the way a penalty against a company can be applied to a Director or other person where the inaccuracy is attributable to him or her.
- Added to that is the process from HMRC decision(s) to Tribunal hearing.

Mr Robinson was fortunate to be represented by Counsel. Most taxpayers do not enjoy that luxury. Usually, the taxpayer's accountant is the first port of call for an unwelcome HMRC decision and/or assessment.

Best advice is to seek a specialist to review matters at an early stage and present options for moving the case forward.

For more go to https://tinyurl.com/55ac8vsa

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Is the taxman's word his bond?

Mala Kapacee highlights a troubling case involving an HMRC-approved tax scheme that caused huge anxiety when the Revenue changed its mind

In my role as a tax investigations adviser, I see the full range of clients, those who took reasonable care or were mis-advised, those who made mistakes and those (the minority) who committed fraud. People who took part in tax avoidance arrangements fall into the first of these categories; they were advised that the arrangements they were going into had HMRC approval.

London Tax Network Ltd recently gave evidence, in the form of case studies, to the House of Lords Economic Affairs Finance Bill Sub-committee on the implementation of the Loan Charge. Our evidence was quoted a number of times in a letter written by the Sub-committee to the Financial Secretary, which highlights areas where HMRC can improve. One case we consider requires further scrutiny revolves around HMRC's review of a particular structure in 2012.

In 2012, HMRC conducted a detailed review of a set of arrangements created and established by a chartered accountant. Having directed a series of queries to the promoter, the responses received resulted in HMRC's Anti Avoidance Group (AAG) writing back stating it was "able to agree that this Hallmark does not apply and as a result the arrangements are not disclosable [under DOTAS]" on tax returns to HMRC.

I have seen the letter dated 20 June 2012 from the HMRC Anti Avoidance Group (Intelligence) to a client's former representative, and a few things can be clearly inferred from its content:

HMRC was aware of the arrangements;

HMRC had reviewed the arrangements and in sufficient detail to have asked relevant questions;

HMRC did not consider the arrangements should be disclosed, as the 'Hallmarks' of a tax avoidance scheme were not met. Arguably, it can also be inferred that HMRC therefore did not consider the arrangements to constitute an aggressive tax avoidance scheme that would fall foul of legislation;

Contrary to all HMRC's marketing against avoidance schemes, the department could be said to have approved this one;

HMRC effectively confirmed the Chartered Accountant's claim that at the time, the arrangement "complies with UK tax legislation";

Despite having reviewed the arrangements in 2012, HMRC did not notify affected taxpayers of any concerns, e.g. that the arrangements did not work and additional taxes could be due. This is a direct contradiction to HMRC's rhetoric to date *"HMRC has never approved these schemes and has always said they don't work"*[1].

Continued on page 6

1 https://www.gov.uk/government/publications/loan-schemes-and-the-loan-charge-an-overview/tax-avoidance-loan-schemes-and-the-loan-charge

Continued from page 5

The client carried out due diligence on the arrangements at the outset and based his decision to continue using them on the written reassurance from HMRC (albeit the letter was not addressed to him directly).

Some 18 months later, in December 2013, HMRC raised an enquiry into the individual's 2011/12 personal tax return – specifically his use of the arrangements discussed above – and the client immediately withdrew from them. Despite being aware of the arrangements for over a year, this was the first time HMRC notified the client they were in any way concerned as to the legitimacy of the arrangements. The enquiry officer pointed out in a letter dated September 2014 that HMRC had *"already reviewed the arrangements and [had] agreed that they [did] not fall within the DOTAS (Disclosure of Tax Avoidance Schemes) regime. HMRC have not agreed that the arrangements are acceptable from a tax law perspective."*

There is a technical difference between whether arrangements should be disclosed and whether they are acceptable from a tax law perspective. Clearly, HMRC were aware of the scheme in 2012. The department made enquiries, received responses and confirmed the scheme was not disclosable. Why did HMRC not point out in 2012 that the arrangements were artificial and would not be accepted in future?

Either HMRC simply looked to respond to the question it was set and looked no further, a terrible 'customer service', or, much more likely, the officers didn't know that in the future, the arrangements would be deemed artificial.

With regard to the first reason, tax advisers who simply respond to the question set without looking further would almost certainly end up facing professional negligence claims and out of business. With regard to the second; if HMRC did not know the arrangements were artificial at that point, how could the taxpayer?!

Further, with HMRC having advised the scheme was neither disclosable nor defective, is it then "fair" to have as part of the Loan Charge protections, that *"where a reasonable disclosure of the use of the tax avoidance scheme was made to HMRC and HMRC did not take action"*, the taxpayer is not subject to the Loan Charge. In this case it was HMRC who confirmed that the scheme was not disclosable and then waited 18 months before taking any action. Further tax liabilities accrued in the 18 months and these arose as a direct consequence of HMRC's letter.

The client wrote to HMRC in July 2019, with various queries relating to the arrangements. They did not receive a response and wrote again on 25 September 2019. The letter was sent by tracked delivery and received by HMRC on 28 September 2019. HMRC finally responded (by email) on 10 September 2020 – it took HMRC nearly a full year to provide only a brief initial response.

In the email response, the HMRC Inspector advised that, due to time constraints and the approaching settlement deadline, his "*full response will not be pulled together until after the 30 September 2020*". To date (February 2021), a "full response" has not yet been received. Suffice to say, this level of customer service is not good enough. For an issue as contentious, sensitive and life changing as the Loan Charge, a one-year response time shows, at the very least, a lack of respect for those affected.

Again, I have had sight of the September 2020 email from HMRC and there are certain areas worth highlighting:

The officer states that the *"marketing for the scheme very specifically stated that you were not an employee and that [xxx] would not deduct tax"*. The client claims to have seen no such marketing statement and, in fact, has binding contracts specifying tax *would* be deducted at source. Regardless of interpretation, HMRC appears to be doing exactly what the taxpayers did; relying on the documentation provided to determine the workings of the arrangements. Yet when it comes to whether the arrangements are aggressive avoidance, HMRC suggest that taxpayers should have looked beyond the information they were given. There is a definite mismatch as to the standard of knowledge HMRC hold taxpayers to and what they demonstrate themselves.

Referring to the June 2012 letter where the AAG confirmed the arrangements were not disclosable, the HMRC Inspector replied *"I note the AAG letter re the hallmarks, and can only comment that, after a discussion with this team, we both agree that this letter is incorrect"*. My client relied on a letter from HMRC confirming the arrangements were not disclosable. Now that HMRC has simply changed its mind, he is caught by the Loan Charge.

HMRC has not, to my knowledge or that of the client, asserted that any information they were given in relation to the arrangements was incorrect or inaccurate.

The client did not rely on HMRC technical guidance pertaining to a *similar* situation, *nor was he* relying on a clearance from HMRC based on a version of the facts that changed on implementation. The June 2012 statement from HMRC's Anti Avoidance Group was based on the exact arrangements the client undertook. Case law says that if a person has relied on HMRC's guidance and can show they lost out as a result of that guidance, the tax treatment applied by the guidance stands, even if it is incorrect.

Further, we are unable to find another example of where one party would be held liable for another party's admitted error.

In this case, the client stands to suffer not only significant financial loss as a direct result of relying on the 2012 letter from HMRC, but also mental and long-term emotional distress. In April 2019 the client said the Loan Charge *"will destroy my quality of life and that of my family... It has already caused me to suffer extreme stress, and is causing huge anxiety for my family. If the Government ploughs on with this retrospective legislation, it will be responsible for devastating the lives of families across generations."*[2] The client has since had to take stress-related early retirement and has been plagued by a series of health issues, in no small part due to continued uncertainty regarding his tax affairs.

Stephen Metcalfe, MP for South Basildon and East Thurrock, has been lobbying HMRC in relation to this case for a number of months. His view in April 2019 was that HMRC had a responsibility to advise users of the scheme that it did not work: *"under HMRC's duty of care and due diligence, it had plenty of opportunity to inform my constituent that things had changed and that the particular arrangement that he had entered into would be liable to taxation. HMRC completely failed to notify my constituent that anything was amiss."*[3] He further noted in February 2021 that *"HMRC should be held to account for the information and reassurance they gave"*.

HMRC clearly reviewed the arrangements in 2012 and advised in writing they were not disclosable; how many other arrangements were dealt with in the same way? And how many other individuals are either unaware of HMRC's letter or unable to afford justice? At the extreme end of the scale, I suggest a full investigation into the reviews HMRC undertook around the early-2010s to see how many of these letters were sent out and that the affected individuals be compensated accordingly. It is no less than what HMRC is expecting of individuals, by having the Loan Charge look back to 2010.

This is an example of a litany of errors and delays by HMRC and in no court of law would a victim be required to pay compensation to the perpetrator. In this case, HMRC wrote that the arrangements were not disclosable and eight years later admitted it was wrong to have done so. HMRC has taken no responsibility for how its advice nor how its own error (and admittance of such) has significantly impacted people's lives. HMRC needs to take responsibility for training its staff and ensuring its advice can be relied upon.

HMRC must be held accountable for its advice. After all, if the Government is above the law, then what is the value of British justice?

Mala Kapacee *specialises in preparation of disclosures to HMRC and resolution of tax enquiries, and is a well-known tax author. Email mala@londontaxnetwork.co.uk*

2 https://hansard.parliament.uk/Commons/2019-04-11/debates/65713A00-68FA-4AEB-B739-B092D6CE2B26/details
3 https://hansard.parliament.uk/Commons/2019-04-11/debates/65713A00-68FA-4AEB-B739-B092D6CE2B26/details

The long arm of HMRC

Adam Craggs and Alice Kemp outline the powers HMRC has at its disposal when conducting a criminal rather than civil investigation

Most readers will be familiar with the powers available to Her Majesty's Revenue & Customs (HMRC) to compel the provision of documents and information from taxpayers and third parties, such as banks and accountants, in the context of a civil HMRC enquiry[1]. What might be less well-known is HMRC's ability to obtain communications data when investigating suspected criminal activity.

Tackling serious organised crime is a priority for HMRC and access to communications data has a vital role to play in meeting that challenge. Under Part 3 of the Investigatory Powers Act 2016 (the IPA), HMRC can request data held by telecommunication operators including the time, duration and location of a telephone call, together with the number dialled ('communications data'). It cannot, however, without the authority of the Secretary of State, ascertain what is being said on the call. This is sometimes described as the 'who', the 'when' and the 'where', but not the 'what'.

Following a Freedom of Information request from our firm RPC, HMRC has confirmed that in 2019 it made 18,464 requests to access communications data; up slightly from the 2018 total of 18,263 requests and a significant increase from the 11,513 requests made in 2010.

With the increase in home working as a consequence of the Covid-19 pandemic, communication data takes on an even more significant role and we anticipate that the number of requests from HMRC for communications data will increase further in 2020 and 2021.

In the context of suspected furlough fraud, HMRC might wish to access communications data to ascertain whether any business calls have been made or received by business mobile telephones issued to furloughed employees. Similarly, HMRC might be interested to learn whether furloughed employees' mobile telephones were located at business premises when the employees made or received a call.

But what about the contents of emails and text messages?

Because of the broad wording of the IPA, 'communications data' does include emails and instant or 'text' messages[2]. But whereas telephone calls and websites tend to be 'in the moment', and leave no lasting record[3], emails are different. Most people tend to keep a record of the emails they receive on their telephone, tablet, laptop or personal computer, which means that there is another aspect to consider – HMRC's ability to access stored data.

There are a number of ways in which HMRC can, in the context of a criminal investigation, access emails or messages stored on electronic devices, but the main ones to be aware of include:

- the special procedure material provisions contained in Schedule 1 and section 14 of the Police and Criminal Evidence Act 1984 (PACE), which can be used to compel the disclosure of material in the possession of a person or organisation, created or acquired in the course of business, held subject to an obligation of confidence or secrecy and likely to be of substantial value to the investigation of the commission of an indictable offence;
- search warrants issued pursuant to section 8 of PACE, to search and seize material (which will normally include computer servers, electronic devices and mobile telephones) located at a specified address (such search warrants are typically issued in relation to both business premises and private residential addresses).

Do you have to provide your password or encryption key?

Of course, in order to comply with various data protection requirements and as a protective cyber security measure, many electronic devices are password-protected and encrypted, which can cause difficulties for investigatory bodies such as HMRC. If a person refuses to provide a password, or encryption key, to

1 See Schedule 36 to the Finance Act 2008.
2 There are additional provisions which relate to internet connection records (see section 62 of the IPA).
3 Unless there is an interception warrant issued under Part 2 of the IPA. This is a complex area of the law and outside the scope of this article.

enable investigators to access lawfully obtained information, they can be compelled to do so. HMRC can issue a notice to that person pursuant to section 49 of the Regulation of Investigatory Powers Act 2000 (RIPA). **Section 49** provides the power to serve a **notice** on a person who is believed to be in possession of a password or encryption key, to provide that password or key within a specified period of time. A knowing failure to comply with a section 49 notice is a criminal offence punishable by an unlimited fine and/or a term of imprisonment of up to two years.[4]

COP 9 as an alternative to a criminal prosecution

While the investigative powers described above are designed to provide evidence that might underly a criminal charge, HMRC is in a different position to most other regulators and prosecutors in that its focus is primarily on the collection of tax revenue.

As a consequence of this differing focus, even when HMRC suspects tax fraud and is in possession of evidence which might justify a criminal prosecution, it may nonetheless choose to go down the Code of Practice 9 (COP 9) route rather than commence a criminal investigation. COP 9 is a civil procedure used in selected cases where HMRC suspect tax fraud but do not wish to carry out a criminal investigation with a view to prosecution. The taxpayer is given the opportunity to make a full disclosure under a contractual arrangement called a Contractual Disclosure Facility.

The factors influencing the decision by HMRC as to whether to proceed by way of COP 9 or criminal investigation where fraud is suspected are many and varied and the presence of communication data may be a factor in the decision-making process. For example, where HMRC is in possession of information from the seizure of emails or relating to the use business mobile telephones, which suggests fraud, it may nonetheless form the view that it will better serve the public interest to offer a COP 9 investigation rather than initiating a criminal investigation.

However, in our experience, cases where a COP 9 is offered after communications data is obtained are very much the exception. Obtaining communications data or a search warrant are all significant steps that can only be undertaken by HMRC if there is no reasonable alternative method of acquiring the information sought. This means that, in practice, a decision to conduct a criminal investigation with a view to a subsequent prosecution is likely to have already been made.

It is important to obtain appropriate specialist legal advice should you become aware that any of the above investigative steps have been utilised by HMRC.

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4 Or up to five years in cases involving national security or child indecency (see section 53(5A)(a) of RIPA).

Comment: Points make prizes and a job in the TPF beckons

The annual Budget has just been presented to Parliament and our inboxes are groaning under the strain of emails offering ‘Budget Updates’; actually, this year’s affair was full of amendments and updates that warrant a long hard look.

Ignoring the bulk of the tax and Covid-related matters I was struck by two particular items.

First was the announcement of the Taxpayer Protection Taskforce (TPF), which is to be formed by HMRC using a £100m investment. I can hear ‘The A-Team’ theme music playing as I type. The announcement says that 1,265 HMRC staff will make up the taskforce and 100 or so will be new to HMRC. The aim is to tackle abuse and to stamp down hard on any exploiters of the Covid schemes that were set up to provide support where it was most needed.

A laudable objective and one that you certainly cannot argue against, especially

as some of the help provided was done is such a rush that normal safeguards were jettisoned for one reason or another.

What this means is that we can expect HMRC activity will increase and with such a large investment they will be looking for results – and quick ones. Fraudsters deserve what they get, but my concern is for taxpayers that are targeted for no genuine reason.

The second piece that caught my eye was the new ‘Points make penalties’ regime, which is covered at https://tinyurl.com/7fepyama

Default surcharges have been a bone of contention for many businesses over the years, and finally HMRC have decided to make changes and base it on a series of penalty points. Remember, this only comes into play for VAT from 2022. Points are going to be awarded for every submission deadline failure and each submission type will hold and accumulate their own points, so VAT return submissions are separate from tax return submissions. Points will be extinguished as set out in the policy paper so a return to compliance is duly rewarded.

Will this work better than a simple surcharge? Only time will tell, but we have a bit of time to get our clients up-to-date. I wonder if a failure will be automatically reported to the TPF?

Tony Margaritelli, Publisher, HMRC EIP

No formal investigation? No problem!

Mark McLaughlin looks at informal enquiries by HMRC and information notices issued during such enquiries

The well-trodden path by HMRC when launching enquiries into an individual's tax return is to issue a notice under TMA 1970, s 9A. A formal enquiry follows a structured process, which provides HMRC with certain powers, and importantly affords taxpayers some statutory protections. For example:

If the taxpayer has filed a self-assessment return and HMRC has not opened a formal enquiry into it, HMRC cannot issue an information notice in respect of that return except in certain limited circumstances (FA 2008, Sch 36, para 21).

Following the opening of an enquiry into an individual's self-assessment return under TMA 1970, s 9A, the taxpayer can apply to the First-tier Tribunal for a direction that HMRC issues a closure notice within a specified period (TMA 1970, 28A(4)).

A return which has been the subject of one enquiry notice within the statutory enquiry 'window' may not generally be the subject of another notice of enquiry under TMA 1970, s 9A.

It should also be noted that HMRC's unrestricted right to open an enquiry under TMA 1970, s 9A is limited by a strict time limit within which such an enquiry may be opened (normally up to 12 months from the filing date for the return); once the period expires, the return is final, subject only to a discovery assessment.

'Informal' enquiries

However, HMRC does not always open formal enquiries when looking into someone's tax affairs. Sometimes information and documents are requested informally. For example, the taxpayer may not have filed self-assessment returns for the period under review, which could cover many tax years. If the taxpayer refuses to cooperate with an informal request for information and documents, as indicated above HMRC could seek to obtain them by issuing an information notice (under FA 2008, Sch 36, para 1).

HMRC's practice of making enquiries outside the statutory framework for doing so was challenged by an application for judicial review in *JJ Management LLP & Ors, R (On the Application Of) v Revenue and Customs & Anor* [2020] EWCA (Civ) 784.

Taxpayer challenge

In that case, one of the claimants (BR) was a successful businessman, who was resident and domiciled in the UK. The other claimants were UK and non-UK corporate entities in which BR was beneficially interested.

In the early 1990s, BR opened a supermarket business in Tenerife, which grew significantly. Since at least June 2016, HMRC had been investigating BR's tax affairs. HMRC's investigation was opened by a letter to BR. No formal enquiry was opened (under TMA 1970, s 9A). Following repeated requests for information and documentation, HMRC issued a formal information notice to BR in July 2017 (under FA 2008, Sch 36, para 1), and third-party information notices to other claimants (pursuant to Sch 36, para 3(1)).

The appellants' application for judicial review was on the grounds (among other things) that where HMRC had not opened an enquiry into a taxpayer's tax return under TMA 1970, s 9A, HMRC did not have a general power to conduct the sort of wide-ranging lengthy investigation that they had been conducting in relation to them.

HMRC's duties and discretion

Pausing there for a moment, it is worth reflecting on HMRC's duties and functions. HMRC's general responsibility for the collection and management of income tax, corporation tax and capital gains tax is set out in *TMA 1970, s 1*.

Furthermore, the powers and duties of HMRC (or the Commissioners for Revenue and Customs, to be more precise) are defined by law, in the Commissioners for Revenue and Customs Act 2005 (CRCA 2005). HMRC is responsible for (among other things) "the collection and management for which the Commissioners of Inland Revenue were responsible before commencement of this section" (CRCA 2005, s 5(1)(a)). HMRC are empowered to do anything which they "think" is necessary, expedient, incidental or conducive in relation to their functions,

However, HMRC appears to interpret this duty quite flexibly. In its Admin Law manual, HMRC states (at ADML3200): "HMRC is therefore responsible for the... collection of tax revenues... and must manage them in the most efficient way. This means that HMRC must apply the law correctly and the Commissioners cannot choose to move away from this position merely because the result seems unfair or unreasonable. To move away from the strict application of the law in this way would be contrary to the will of Parliament.

"However, there may be circumstances where applying the discretion would result in a more efficient management of the revenue and in such cases the Commissioners can choose to do so."

HMRC has sometimes exercised discretion under its powers of collection and management in the taxpayer's favour, although the circumstances in which they will do so in practice have diminished significantly following the House of Lords' decision in *R (oao Wilkinson) v CIR* [2005] UKHL 30. The tests which HMRC apply in considering whether its discretion under CRCA 2005, s 5 can be exercised are discussed in its guidance at ADML3400.

HMRC's powers of collection and management are normally considered in the context of whether they should be applied in the taxpayer's favour. However, can HMRC's discretion be exercised in reverse?

Formal and informal

Returning to *JJ Management*, the High Court ([2019] EWHC 2006 (Admin)) held that (under CRCA 2005, s 5(1) and TMA 1970, s 1) HMRC's functions included the collection of taxes; conducting an investigation into whether a taxpayer had declared all his income and paid the correct amount of tax was expedient or conducive to the exercise of that function; and it was, therefore, something that HMRC had statutory power to do (under CRCA 2005, s 9(1)).

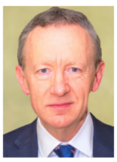
The statutory scheme was such that HMRC's functions included not only opening an enquiry into a return under TMA 1970, s 9A during the enquiry window, but also checking returns without opening a section 9A enquiry after the enquiry window had closed.

In the subsequent Court of Appeal hearing, the appellant argued (among other things) that the High Court judge erred in finding that CRCA 2005, s 9(1) empowered HMRC to conduct 'informal investigations'. However, the Court of Appeal disagreed, and concluded that the High Court was correct to hold that HMRC has the power to conduct such investigations.

HMRC's functions included not only checking tax returns without opening an enquiry under TMA 1970, s 9A, but also checking returns after the enquiry window had closed. Judicial review of the exercise of that power was available on ordinary public law grounds, but in practice it would take a wholly exceptional case on its legal merits to justify judicial review of a discretionary decision by HMRC to conduct an informal investigation of the kind conducted in the present case. The appellants' appeal was dismissed.

Nudge, nudge?

As if HMRC did not have sufficiently extensive powers before *JJ Management*, those powers now seem even wider. The Court of Appeal's judgment will be worrying for those taxpayers being asked questions as part of informal HMRC investigations, as there appears to be little protection for the taxpayer unless HMRC is acting unlawfully in its conduct. HMRC's practice of issuing 'nudge' letters to taxpayers as opposed to opening formal enquiries looks set to continue, and informal checks may become the means by which HMRC investigate (for example) incorrect claims by employers and the self-employed for government payments during the Covid-19 pandemic.



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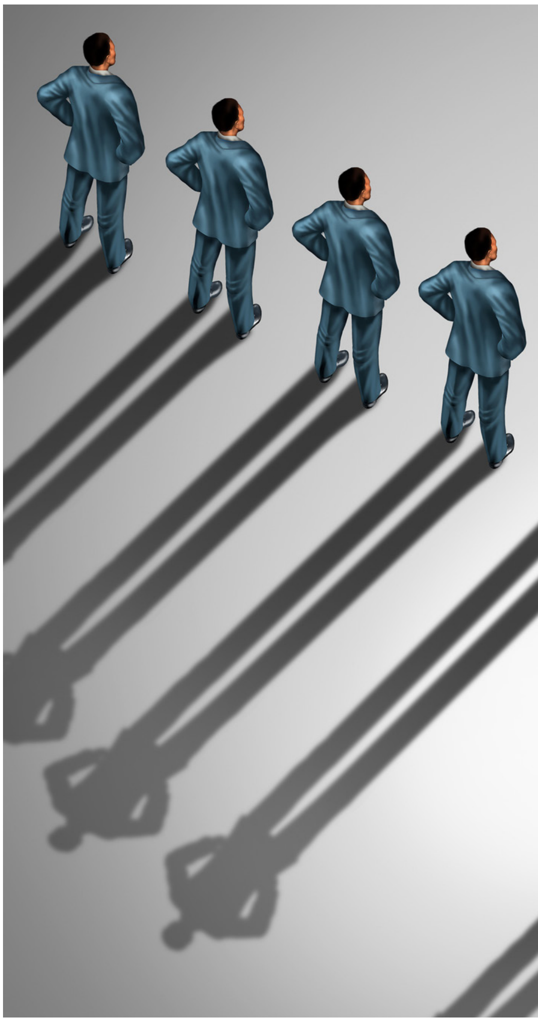
Joint Liability Notices: be afraid...

With the Joint Liability Notice, the taxman has added a powerful weapon to his armoury. David Lewis and Haris Rehman explain what a JLN is and how it has come about



Although a cornerstone of the modern commercial world, HMRC has always experienced operational difficulties with entities such as companies that enjoy the benefit of limited liability.

To overcome this, in the past few years HMRC has attempted to introduce measures to "pierce the corporate veil" – that is the "veil" that shields shareholders from personal responsibility for the debts of the businesses they own.

A good example of this approach is the introduction of the 'Senior Accounting Officer' (SAO) provisions, which operate to pin personal responsibility onto a specific identifiable senior executive in a large corporate for the tax obligations of the company for which he or she might work. The SAO has to sign an annual certificate to say whether the company does or does not have systems and processes in place to deliver the right tax result. If he or she fails to submit a certificate, or submits a certificate that proves to be incorrect, then he/she is personally liable to a hefty penalty.

Another example is the ability to force company directors to make a payment of a personal security – effectively a payment upfront on account of potential tax liabilities – in any situation where HMRC has grounds to suspect that the company might fail to pay its liabilities. Formerly only limited to VAT, these have recently been extended to include PAYE and NIC and other corporate liabilities. In addition to these, there has also been the part restoration of preferential creditor status for some tax regimes from 1 December 2020.

The latest policy initiative in this area is the Joint Liability Notice (JLN), now legislated at Schedule 13 of Finance Act 2020. The overall intention is to redress the persistent HMRC complaint that, if and when a company becomes insolvent, the tax authority is often left holding the baby of the vast bulk of unsecured debt.

Tax officials often complain that, compared with normal creditors, HMRC is in a uniquely disadvantaged position. They point out that there is often a considerable period between the time that a transaction occurs and the associated time that the tax charge relating to that transaction becomes payable, particularly after an enquiry or, in a case of dispute, when the litigation process has been completed.

Moreover, they complain that, unlike trade creditors or service providers, HMRC has no wider leverage to threaten to cut off key services or supplies until outstanding liabilities are paid. Of course, this rather ignores the fact that VAT on sales can be payable to HMRC before the trader is actually paid by his/her customer, but HMRC can see these things from something of a distorted viewpoint.

Circumstances in which the JLN can be used

The new provisions, effective for tax periods that ended after 22 July 2020, allow HMRC to issue a notice that creates shared responsibility tax liabilities between the company and the director, shareholder or equivalent (i.e. those individuals who have a 'relevant connection'). Where the company no longer exists, the liability transfers to the individual entirely.

Schedule 13 of the Finance Act 2020 (FA 2020) outlines the scenarios in which a JLN can be issued. These are:

1. The company has engaged in tax avoidance or evasion.
2. The individuals have been involved in repeated insolvency of companies (commonly termed 'phoenixism').
3. A penalty has been issued for facilitating avoidance or evasion.

The potential for enhanced personal exposure for individuals acting as directors or officers of a company are clear. We now look at each of these scenarios in more detail.

Tax avoidance and evasion

The consultation papers preceding the draft clauses made clear what HMRC had in mind. Practitioners themselves will be all too aware of the proliferation of Disguised Remuneration schemes, where individual taxpayers have used bankruptcy as a mechanism to escape

tax liabilities arising from their participation in schemes that were (at least in the eyes of HMRC) doomed to fail. The position would be exacerbated where individuals had been involved in behaviour that was more clearly evasion from the outset, such as where a company as an employer failed to operate PAYE – or did operate PAYE but never paid the tax and NIC to HMRC.

There are five conditions for the valid issue of a notice, as follows:

a. The company has entered into tax avoidance arrangements or tax evasion.
b. The company is subject to an insolvency procedure or there is a “serious possibility” that it will do so.
c. The individual was responsible for the conduct under condition A or has received a benefit arising from those arrangements and was a director/ shadow director or participator in the company.
d. There is or likely to be a liability referable to the conduct under condition A.
e. There is a “serious possibility” that the tax liability under Condition D will not be paid.

The definitions of tax avoidance arrangements are those that will be widely recognised for the purposes of direct tax, particularly to include those that fall within DOTAS (Disclosure Of Tax Avoidance Schemes) which have now been in operation for over a decade.

What does this mean in practice for HMRC?

Interestingly, the definition of tax evasion primarily relies upon the well-established failures to comply with tax obligations, such as inaccurate returns, failures to notify chargeability and failure to make tax returns on time. However, there is an additional challenge for HMRC in that each failure must be the result of “deliberate” behaviour. Although the civil standard of proof applies, the threshold for HMRC can still be difficult to meet in practice since HMRC needs to demonstrate that the taxpayer had conscious knowledge and intention towards the loss of tax, rather than it being due to a lack of reasonable care.

Despite HMRC commitments to provide further clarity in guidance, the provisions themselves contain a number of features that seem ripe for debate, challenge and probably litigation in the future. One such obvious example seems to be the inclusion of the phrase “serious possibility”. One can only speculate as to when a mere possibility becomes sufficiently likely that it becomes a “serious” possibility. No doubt we can expect this terminology to be the subject of many learned debates in the Tribunals and courts for many years to come.

Repeated insolvency (‘Phoenixism’)

Where a JLN is issued by HMRC, the insolvent company and those individuals with a relevant connection are made jointly and severally liable for the company’s tax liabilities and penalties. A relevant connection for circumstance 1 above (tax avoidance and evasion) relates to an individual who had some direct involvement in the tax avoidance or evasion concerned, such as facilitating, implementing or benefitting from the arrangement.

However, in the case of phoenixism, there is no need to demonstrate actual involvement. In fact, an individual can have a relevant connection and so be jointly and severally liable if they have merely been a director, shadow director or participator of the old company or companies and director, shadow director, participator or involved in the management of the new company or companies in question, within the previous five years.

The legislation states that a JLN may not

Continued on page 14

Continued from page 13

be issued after the end of the period of two years beginning with the day on which HMRC first became aware of facts sufficient for them reasonably to conclude that conditions A to D are met. The four conditions for a valid notice to be issued when dealing with phoenixism are as follows:

Condition A is that there are at least two companies ("the old companies") in the case of each of which

a. the individual had a relevant connection with the company at any time during the period of five years ending with the day on which the notice is given ("the five-year period"),
b. the company became subject to an insolvency procedure during the five-year period, and
c. at the time when the company became subject to that procedure—
    i. the company had a tax liability, or
    ii. the company had failed to submit a relevant return or other document, or to make a relevant declaration or application, that it was required to submit or make, or
    iii. the company had submitted a relevant return or other document, or had made a relevant declaration or application, but an act or omission on the part of the company had prevented HMRC from dealing with it.

Condition B is that another company ("the new company") is or has been carrying on a trade or activity that is the same as, or is similar to, a trade or activity previously carried on by

a. Each of the old companies (if there are two of them) or;
b. Any two of the old companies (if there are more than two)

Condition C is that the individual has had a relevant connection with the new company at any time during the five-year period.

Condition D is that at the time when the notice is given

a. At least one of the old companies has a tax liability, and
b. The total amount of the tax liabilities of those companies
    i. Is more than £10,000, and
    ii. Is more than 50% of the total amount of those companies' liabilities to their unsecured creditors.

A penalty has been issued for facilitating avoidance or evasion

An authorised HMRC officer may issue a joint liability notice to an individual where a penalty has been imposed for facilitating avoidance or evasion if it appears to the officer that these four conditions are met:

Condition A is that a penalty under any of the specified provisions has been imposed on a company by HMRC, or proceedings have been commenced before the First – Tier Tribunal for a penalty under any of those provisions to be imposed on a company.

Condition B is that the company is subject to an insolvency procedure, or there is a serious possibility of the company becoming subject to an insolvency procedure.

Condition C is that the individual was a director or shadow director of the company, or a participator in it, at the time of any act or omission in respect of which the penalty was imposed or the proceedings for the penalty were commenced.

Condition D is that there is a serious possibility that some or all of the penalty will not be paid.

What is the potential impact on clients?

As HMRC prepare to use these new powers, there will no doubt be a transitional period where caseworkers get used to implementing them – and no doubt mistakes will be made and mis-steps will be taken. Therefore, practitioners need to be keenly aware of the statutory safeguards available to their clients. Firstly, taxpayers served the notice can ask within 30 days for an internal review of the decision to issue the JLN.

Alternatively or additionally, taxpayers still have the right to appeal the issue to the independent First Tier Tribunal, either on the grounds that the conditions have not been met or that the notice is not necessary for the protection of the revenue. The tribunal can also set aside the notice, or vary an amount specified if it appears to the tribunal that the amount specified is incorrect. If none of the aforementioned grounds are met then the tribunal must uphold the notice.

Bearing in mind the considerable powers conferred by these new provisions and the wide range of circumstances where HMRC apparently intends to use them, we can expect practitioners to be confronted with these notices frequently in the future. As we said at the start, HMRC have long been frustrated by the limited liability protection afforded by the corporate structure to what they see as the misbehaviour of company directors. Having been provided with a weapon to overcome that protection, it is only to be expected that they will be keen to use it wherever possible.

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Right and wrong

What is wrongful trading? Elliot Green explains all – and questions whether the Government's decision to suspend the wrongful trading rules last year was a wise one

Wrongful trading is trading whilst insolvent without having reasonable prospect of avoiding insolvent liquidation. However, a Director is not necessarily liable for such loss caused if he or she took every step to minimise the loss.

Two things need to happen therefore for a Director to be liable to creditors upon a company going into insolvent liquidation in such circumstances: there needs to be a loss to creditors after the date at which the wrongful trading commenced; and the loss suffered by creditors was not minimised.

In most cases the company in question is already insolvent at the point when the foreseeability of insolvency is deemed inevitable but it need not be.

A company that is not insolvent can still inevitably go into liquidation. An example would be a change of market conditions that leads to a company having no future. With that in mind it is not inconceivable that a solvent company could be the focus subsequently of a wrongful trading claim by a liquidator but it would be the exception rather than the rule.

Wrongful trading or insolvent trading: which is unlawful?

The short answer is wrongful trading is the unlawful act as set out in Section 214 of the Insolvency Act 1986. Insolvent trading, or trading whilst insolvent, would be part of the evidence of an act of wrongful trading, however it is not necessarily an unlawful act. It depends upon the facts of the case.

So what is the difference between the two? There is no statutory recognition afforded to insolvent trading. While undesirable in many instances it is not necessarily unlawful.

Wrongful trading is an action that can only be undertaken by a person occupying the position of Director of a limited company. That position of 'Director' can be determined in a number of ways, being official (recognised at Companies House and in a company's statutory register), de facto or shadow as set out in the Companies Act.

Wrongful trading is the act by Directors of a period of trading in which debts and liabilities are incurred and typically increase, whilst having no reasonable prospect of a company avoiding insolvent liquidation.

It is the action by Directors of accepting credit when it is highly unlikely that the same would be discharged due to the financial position of a company.

Wrongful trading only applies to company Directors, whereas insolvent trading can be undertaken by individuals such as sole traders.

The solvency test

There are two tests for solvency defined in Section 123 of the Insolvency Act 1986, being:

- are your assets exceeded by your liabilities?
- are you failing to discharge your debts as and when they fall due?

If you satisfy either criteria then you are technically insolvent in accordance with the definition in the legislation.

What is wrongful trading risk?

What is the risk? Well if you are accused by a liquidator of a company of wrongful trading then as Director you could be personally liable for the damage the company suffered during a period of wrongful trading – so do not do it! If in any doubt take professional advice at the earliest possible opportunity.

Often such advice can be obtained without charge for an initial consultation with a Licensed Insolvency Practitioner.

What is wrongful trading Covid-19 suspension?

The Government announced the suspension of the wrongful trading provisions with the following message on its website in a press release on 28 March 2020: "...temporarily suspending wrongful trading provisions retrospectively from 1 March 2020 for three months for company directors so they can keep their businesses going without the threat of personal liability".

There appears little doubt that whether you support or dissent from the Government's approach to tackling the Coronavirus that economic shockwaves are being felt. Just look at the High Street; the emptiness and absence of activity is there for all to witness when seeking to fill their shopping bag of

essentials. Press reports are replete with suggestions that a substantial number of businesses will close, which risks extending to a material proportion of the UK's economy.

To address that position it appears the Government considers that suspension of Section 214 of the Insolvency Act 1986 ('Wrongful Trading') will assist. At the time the then Business Secretary Alok Sharma said: "Today's measures will also reduce the burden on business, giving bosses much-needed breathing space to keep their workers employed and their companies going."

So how will suspension of wrongful trading provide a breathing space? It sounds positive and a useful suspension to deploy but on closer inspection can it work as it appears to have been publicly promoted? We are right to speculate about it because the Government was quick to make its seemingly opaque plans public but it seems arguably rather short on the specifics.

In short, it appears to be an unfashionable claim to bring. It is considered expensive, difficult, risky and very time-consuming. Insolvency literature is replete with reference to it and whilst the consequential publicly reported court cases do ascertain considerable prominence, they do not appear as voluminous or as routine as claims for antecedent transactions, misfeasance and unlawful dividends.

With that in mind, it is perhaps remarkable that the Government has sought to focus on it given the extent of its reach relative to other more widely litigated liquidator claims. It appears to me to be a public relations proposition given many Directors may be aware of the existence of wrongful trading but perhaps not so aware of the number of such claims issued.

What is wrong with wrongful trading?

Wrongful trading is not the same as obtaining credit by deception, but a Director has a duty to creditors while promoting the company's success. Section 172(3) of the Companies Act 2006 spells this out: "The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

Obtaining credit by deception takes many forms such as Fraudulent Trading, which is set out in Section 213 of the Insolvency Act 1986. But this is **not** wrongful trading.

A distinction is that wrongful trading requires no finding of dishonesty but a reasonable Director in compliance with their Director Duties will not usually engage in such wrongful acts as wrongful trading.

The general issue at large as to what is the 'wrong' or what is wrong with wrongful trading, was notably promulgated by the late Gabriel Moss QC in Insolvency Intelligence in 2017 in his article '**No compensation for wrongful trading – where did it all go wrong?**', where he wrote that "... directors should be deterred from causing debtor companies to take on liabilities which they have no reasonable prospect of paying. If that occurs, then subject to the statutory criteria for liability, compensation should be available for creditors whose debts have been wrongfully incurred."

The wrongful trading trade-off

Does it not remain rather undesirable in continuing to trade for a company to accept credit and take on liabilities that they have no reasonable prospect of discharging, whenever such an event arises?

I cannot see any justification for a company shifting a loss onto another company save if indeed there has been full and frank disclosure of such a prospect arising and with prior agreement.

Of course, the company causing such a loss may well plead that there was never any **intention** to cause a loss but the requirement to avoid it however arises when someone **ought to have known** that it was an inevitability.

The Government says that it is looking to provide businesses with a breathing space to keep their employees and their companies going. Does that mean we should sanction wrongful acts?

Suspension of Wrongful Trading is conceivably undesirable because firstly, a wrongful act arguably should not be suspended – as a matter of principle. It may risk perception of affording a rogue trader the conceivable right to roam unchecked and unfettered – at least during the period of the suspension. What message does it send out to Directors?

The creditor who suffers due to the wrongful trading of a Director who ought to have stopped trading sooner would rightfully feel aggrieved save if he was compensated by the government expeditiously. If it was to go further and then subsequently cause the customer's business to fold also, then the Government will through its own policy be at risk of not only sanctioning a wrong but also through doing so, it risks making a problem worse. It risks the

Continued on page 18

Continued from page 17

prospect of passing a parcel of debt around. In doing so there could be businesses that are hit much later down the chain that might not be in a position to take advantage of the wrongful trading suspension.

Secondly, it actually does not appear to create a breathing space by safeguarding jobs or companies; it merely reduces a liability which **may** arise. The rationale for that proposition is that suspension of wrongful trading from a particular date is not suspension of wrongful trading per se. It is inherent that liquidation is inevitable for wrongful trading to arise in the first place so it is axiomatic it does nothing more than put off the inevitable. It is perhaps ironic that wrongful trading as a provision is one rooted in avoidance of putting off the inevitable.

Observation

The question is, should we sanction the consequences of a wrongful act to seek to alleviate the current economic pressures by making it permissible for someone to cause loss to another?

Does that not send the wrong signals out to the business community? Does that not infringe the cardinal principle that a wrong ought to have a remedy?

If the Government wanted to relieve some of the symptoms of its Coronavirus policy for businesses, then rather than a suspension of wrongful trading there are many options available to it besides sanctioning of the wrongful act on another.

It is worth perhaps remembering that wrongful trading was put on the statute book to deal with a very real problem that was considered inherently undesirable which other laws did not adequately address due to the very high threshold for Fraudulent Trading.

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So who's to blame?

Jack Prytherch examines the issues around a failure to file returns by third parties and the imposition of 'deliberate' penalties

In *H Dhaliwal v HMRC* [2020] UKFTT 463 (TC), the First-tier Tribunal (Tax Chamber) held that, when determining whether there was deliberate behaviour for penalties where a taxpayer has delegated the filing of tax returns to another person, HMRC must show that the other person has deliberately failed to file the return. The decision has important implications for agents who regularly file returns on behalf of clients.

Background

The appeal concerned various penalty assessments raised by HMRC against the appellant, Mrs H. Dhaliwal, relating to her failure to submit tax returns on time for the tax years 2010/11 and 2012/13. This included penalties under Schedule 55 to the Finance Act 2009 (Schedule 55) for the deliberate withholding of information from HMRC by failing to make the returns.

Schedule 55 provides for different levels of penalty to be imposed depending on the behaviour of the taxpayer – namely, whether the withholding of information was:

- deliberate and concealed (where the taxpayer deliberately withholds the information and makes arrangements to conceal the fact that the information has been withheld);
- deliberate but not concealed (where the taxpayer deliberately withholds the information but does not make arrangements to conceal the fact that the information has been withheld); or
- not deliberate (for example, careless).

Under Schedule 55, penalties do not arise if the taxpayer can show that it had a reasonable excuse for failing to make the return. The concept of 'reasonable excuse' is expressly stated to not include (among other things) where the taxpayer relied on any other person to do anything (unless the taxpayer took reasonable care to avoid the failure). However, the burden of proof is on HMRC to show that the taxpayer deliberately withheld information by failing to make a return.

The appellant managed restaurants across a number of cities in the UK and spent a considerable amount of time travelling between them. The restaurants formed part of the family business and were owned by a company (of which she and her husband were the directors). The business was sold to a venture capital business in 2013 and both the appellant and her husband, having initially been retained by the new owners, were subsequently made redundant.

During the same period, the appellant had primary care responsibilities for looking after her father and her parents-in-law, all of whom had been seriously ill.

The appeal

It was not disputed that the appellant had failed to file tax returns on time and made late payments. The only questions for the Tribunal were therefore whether:

- the appellant had deliberately withheld information from HMRC; and/or
- the appellant had a reasonable excuse.

The appellant argued that, throughout the relevant period, the behaviour that led to the failure to make the returns was not deliberate, and that the pressure of her work and family illnesses meant that she had left tax compliance and other such financial matters to her husband (and ultimately their accountant). She claimed that she was unaware that her husband had not filed

the returns and that she did know why they were not filed. She also contended that the pressures of work and family issues amounted to a reasonable excuse for the failure to file the returns.

HMRC, on the other hand, pointed out that all other tax returns for the periods before, between and after the two years in question had been filed on time and that the liability for each of those periods was substantially lower than those two years. They argued, therefore, that the appellant was aware of, and able to comply with, her obligations and deliberately failed to file the relevant returns on time.

HMRC further argued that the fact that the appellant delegated responsibility for filing her returns to her husband was irrelevant – the responsibility to file them ultimately lay with her and she had not shown any reasonable excuse for not doing so.

Decision

Surprisingly, neither party referred to any case law concerning what amounts to deliberate behaviour for penalty purposes. The meaning of the term 'deliberate' was, for example, considered in *Auxilium Project Management v HMRC* [2016] UKFTT 249, where the Tribunal held that a deliberate error (in that case under Schedule 24 to the Finance Act 2007) occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely on it as an accurate document. This is a subjective test and the courts will consider what the taxpayer's knowledge and intentions were at the time of the error.

In this case, in the absence of any representations, the Tribunal adopted the stance that, for deliberate behaviour to occur, there must be a '*conscious act*' on the part of the relevant person to undertake that behaviour. The Tribunal ultimately accepted the appellant's submissions that she left tax matters to her husband, was unaware of the failure to file, and therefore did not herself deliberately withhold information by failing to file returns.

The Tribunal addressed HMRC's argument that the taxpayer was still ultimately responsible for her own tax affairs as follows: "Although we note that the responsibility to file returns remains with a taxpayer where the taxpayer has delegated such filing to another person, we consider that in order for HMRC to satisfy the burden of proof upon them to show that the failure to file was deliberate, it would be necessary to show that such other person had deliberately failed to file the return if the appellant was unaware of the failure to file."

In this case, although the appellant had left tax compliance matters to her husband, the tax returns in question were in practice dealt with by an agent (their accountant). No submissions were made by HMRC as to specifically who, other than the appellant, may have acted deliberately. The Tribunal determined that the mere fact that the returns were filed late and the amount of tax due was substantially higher than normal was not sufficient to evidence that there was, on the balance of probabilities, the necessary deliberate behaviour on the part of another unspecified person which could be attributed to the appellant.

On that basis, HMRC had not discharged the burden of proof to show that the appellant acted deliberately. However, the Tribunal did not accept that the appellant had a reasonable excuse on the facts, meaning that a penalty (albeit for a lower amount) should still be imposed.

Comment

The case has important implication for tax advisors and accountants who regularly file returns on behalf of clients. It shows that not only is the burden of proof on HMRC to demonstrate that there was deliberate behaviour involved but also that, where the taxpayer has entirely delegated responsibility for the filing of their tax returns to an advisor (likely to have to be proved on a case-by-case basis), the advisor (and not just the taxpayer) acted deliberately.

Where HMRC cannot prove this, the penalty must instead be assessed based on careless behaviour (and, ultimately, taxpayers may be able to show that they had a reasonable excuse depending on the facts).

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Tipping the scales?

How is HMRC faring in its mission to strike the right balance between its powers and taxpayer safeguards? Robin Williamson reports

In evaluating the implementation of powers and safeguards introduced since 2012, HMRC has undertaken to abide by 21 commitments to improve its performance.

The evaluation measured how far the new powers and taxpayer safeguards accord with the principles set out in Modernising Powers, Deterrents and Safeguards ("the Powers Review") carried out between 2006 and 2012.

But this exercise missed an opportunity to assess the underlying policy, which in some cases – notably the effect of the Requirement to Correct (RTC) legislation on unrepresented, low-income individuals – has departed a very long way from the Powers Review principle to support those who seek to comply but to come down hard on avoiders.

HMRC's implementation of powers and safeguards

The publication of HMRC's report Evaluation of HMRC's implementation of powers, obligations and safeguards introduced since 2012 on 4 February 2021 followed a lengthy consultation which was begun by the Financial Secretary to the Treasury, Rt Hon Jesse Norman MP, announcing on 22 July 2019 that he had asked HMRC "to evaluate the implementation of powers introduced since 2012 in relation to the powers and safeguards principles, engaging with stakeholders, including taxpayers and their representatives".

For some years there had been a prevailing sense that the balance between HMRC powers and taxpayer safeguards was tilting too far in favour of the former. In its report The Powers of HMRC: Treating Taxpayers Fairly, the House of Lords Economic Affairs Committee concluded that pressure on HMRC to crack down on aggressive avoidance and deliberate evasion, necessary though that was, had left it with insufficient resources to fulfil its obligations to treat taxpayers fairly and in accordance with the Charter. The drive to tackle avoidance and evasion with diminishing resources, their Lordships said, had meant that the principles set out in the Powers Review, when HMRC sought to update and modernise the powers of the merged department, were being forgotten.

Echoing those principles, their Lordships said "there is a clear difference in culpability, for example, between deliberate and contrived tax avoidance by sophisticated, high-income individuals, and uninformed or naïve decisions by unrepresented taxpayers", and the Government should make a clearer distinction between the two in its rhetoric on tax avoidance. A similar theme emerged from Sir Amyas Morse's independent review of the policy and implementation of the loan charge (also December 2019) which considered the extent to which the loan charge, despite something like it being necessary to ensure that everyone paid their fair share of tax, prompted serious questions about how proportionate it was in terms of its design and effect on individuals. He concluded that "elements of the loan charge went too far in undermining or overriding taxpayer protections".

In its evaluation report, HMRC concluded that "overall… the approach to implementing powers introduced since 2012 has been broadly consistent with the 2005-2012 Powers Review principles", while being clear that it was the implementation of the post-2012 powers, not the policy underlying them, that was being evaluated.

HMRC's 21 commitments

Nevertheless, HMRC has acknowledged that in some instances brought to their attention "more could have been done to demonstrate that taxpayers' circumstances had been understood and taken into account when difficult decisions that affected them were made".

The evaluation sets out 21 commitments that HMRC has undertaken, which include matters such as:

- reviewing, updating and where appropriate revising guidance on taxpayers' rights and obligations in respect of various powers;
- exploring ways to improve awareness of HMRC's internal governance processes, especially with regard to anti-avoidance measures such as the GAAR, accelerated payment and follower notices, and the RTC legislation;
- improving some of HMRC's compliance communications, such as letters sent during an enquiry;
- better supporting those in financial hardship;
- improving the experience of taxpayers who correct their tax through the Worldwide Disclosure Facility;
- also improving HMRC's engagement with hard-to-reach audiences through working with voluntary and community organisations, and aspects of customer experience

particularly where taxpayers need extra support; and

- reviewing and updating guidance on reasonable excuse and building consistency of approach internally.

When ignorance of the law can be a reasonable excuse

What the evaluation says about HMRC's application of the reasonable excuse defence to the charging of certain penalties is of particular interest in the context of recent case law.

What was once thought to be a hard and fast principle has now been modified by the Upper Tribunal in Perrin v HMRC [2018] UKUT 156 (TCC). Paragraph 82 of that judgment reads as follows:

"One situation that can sometimes cause difficulties is when the taxpayer's asserted reasonable excuse is purely that he/she did not know of the particular requirement that has been shown to have been breached. It is a much-cited aphorism that 'ignorance of the law is no excuse', and on occasion this has been given as the reason why the defence of reasonable excuse cannot be available in such circumstances. We see no basis for this argument. Some requirements of the law are well-known, simple and straightforward but others are much less so. It will be a matter of judgment for the [First-tier Tribunal] in each case whether it was objectively reasonable for the particular taxpayer, in the circumstances of the case, to have been ignorant of the requirement in question, and for how long."

In brief, ignorance of the law can be a reasonable excuse if the taxpayer's ignorance, viewed objectively, was reasonable given the taxpayer's particular circumstances or attributes.

In a later First-tier Tribunal case, Jacques v HMRC Commrs [2020] UKFTT 311 (TC), the judge followed the Upper Tribunal in Perrin in finding that the appellant, a PAYE taxpayer with no experience of self-assessment, had a reasonable excuse for not submitting a tax return to notify his liability to the High-Income Child Benefit Charge (HICBC) until "nudged"

Continued on page 22

Continued from page 21

by HMRC. The judge, while acknowledging that HMRC had no obligation to notify every taxpayer of every change in the law that might apply to them, said that, equally, the taxpayer is not obliged to "go rummaging through all HMRC's information on the off-chance that there might be something which is hidden away in it which is relevant to his tax position".

How HMRC implements reasonable excuse

And yet, evidence submitted by the Low Incomes Tax Reform Group to the evaluation contains a case history where a low-income taxpayer unwittingly fell foul of the RTC rules and ended up with a penalty. This is cited as Example 1 in the evaluation report (on page 20):

"Mr A first received his overseas pensions in 2007, while resident in the Netherlands, and paid tax on it to the Dutch tax authority. He moved to the UK in 2010 and took up full-time employment. As a result, his total taxable income exceeded the UK personal allowance from 2010/11 to 2012/13 and under UK law he should have notified HMRC about the pension and paid UK tax on it. HMRC wrote to Mr A in April 2019, after receiving information from the Dutch tax authority about his overseas pension income. Mr A told HMRC he did not realise his overseas pension might be taxable in the UK, and contacted Tax Help for Older People (THOP) for help. THOP argued Mr A had a reasonable excuse for failing to comply with the [Requirement to Correct (RTC) legislation] because he thought that the pensions being sourced overseas and having overseas tax deducted meant they were taxable overseas and not in the UK. He was also unaware if he had any obligation under RTC, because he thought he was compliant. HMRC did not agree that Mr A's circumstances constituted a reasonable excuse. As a result, THOP said Mr A paid £3,334 in tax, interest and penalties, including penalties of £1,809 for failing to comply with the RTC. THOP then requested HMRC remit the debt. HMRC can only remit debt in very limited circumstances and instead agreed a time to pay arrangement over three years. THOP said this is causing the taxpayer financial hardship."

The published evaluation is ambivalent as to whether it was right or reasonable to turn down a plea of reasonable excuse in the circumstances of that case, given that a reasonable excuse defence is allowed by the RTC legislation and HMRC simply chose not to apply it. But it does report the view of the tax agents on the consultative forum that HMRC could have done more to ensure such taxpayers were aware of their obligations. Few ordinary taxpayers have heard of the RTC legislation and fewer still have any intention of evading or avoiding tax by hiding activities, income or assets offshore. Mr A's is not the only such case cited in the evaluation – the Tax Investigation Practitioners Group contributed a similar story in Example 19 (on page 45).

As the RTC legislation is aimed at egregious avoidance and evasion, the penalties are severe – 200% of the potential lost revenue, mitigable to 150% in the case of prompted disclosure. Hence the exceedingly large penalties element in Mr A's settlement figure in the example above.

The evaluation report was clear that it was only intended to cover implementation, not the underlying policy – but to operate a policy that imposes 150% tax-geared penalties on people like Mr A for mistakenly thinking that their income is taxable in the country where tax has been automatically deducted is not only harsh, it is quite contrary to the Powers Review principle to "support those who seek to comply but come down hard on those who seek an unfair advantage through non-compliance". In the RTC legislation, the tax authority has come down equally hard on the innocent and the guilty, and HMRC's approach to implementing the rules provides no mitigation in these cases.

Conclusion

Hard cases make bad law. It is good that the evaluation has taken place and that HMRC has signed up to the 21 commitments to improve their implementation of the post-2012 powers. But, as the LITRG spokesman acutely observed, the evaluation report is worth nothing on its own without a genuine and concerted effort by HMRC to act on their 21 new commitments. No doubt HMRC will do its best on the implementation.

However, the failure to evaluate the underlying policies has missed at least one opportunity to correct the skewed balance between pursuit of the avoider and support for the naturally compliant in the egregious way in which the RTC legislation bears down upon innocent mistake. Penalty levels which can go no lower than 150% of potential lost revenue for prompted disclosure, or 100% for unprompted disclosure, are a far cry from Powers Review inaccuracy or failure-to-notify penalties, which can be reduced to as low as zero for unprompted disclosure even where there is an offshore element. But matters of underlying policy takes us into the political arena, in which HMRC is less influential than certain other organs of government. Tax practitioners who care about such matters should write to their MP.

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