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UK Tax Disputes Digest

Winter 2024

Contents

Introduction

Welcome to the winter 2024 edition of our UK Tax Disputes Digest: a high-level summary of key developments in contentious tax over the last few months for heads of tax, finance directors, general counsel and other in-house professionals.

As with previous editions, we have seen a continued increase in HMRC activity across various areas. Both individual and corporate taxpayers would be well-advised to check their tax position as soon as possible to prepare for any potential HMRC investigation into their tax affairs.

In this edition, we look at just a few of these developments, including the latest on R&D compliance, HMRC's new crypto asset disclosure facility, a letter campaign targeting those businesses impacted by OECD Pillar Two, and the latest series of other HMRC nudge campaigns.

We also cover a number of notable tax cases and other interesting procedural decisions. This includes an important Supreme Court decision as to whether shares or options should be treated as "employment-related", as well as a case from the tribunals concerning an unusual decision to allow tax appeal proceedings to be heard in private.

About the team

With 15 partners in our London office, the CMS tax team is one of the largest in the City and advises high-profile clients across a wide range of sectors and all areas of tax. As part of that general tax practice (and the CMS global network with tax capability in over 70 offices), our tax team regularly helps both individuals and corporates with all aspects of tax dispute prevention, management and resolution.

The CMS disputes team is one of the UK's leading contentious practices with some 500 disputes lawyers in the UK alone. We regularly appear before all courts and have more sector and practice expertise among our disputes lawyers than any other firm. We are one of only a few firms to routinely appear in The Lawyer's annual reports on leading cases both for first instance and appeal cases.

The firm's contentious tax practice pools the resources of the CMS tax and disputes teams, including dedicated tax disputes specialists.

For more information on our team and the type of work we undertake, please see here.

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In focus: *Vermilion* – a noble cause or a taxing problem?

Whilst the recent Supreme Court decision in *HMRC v Vermilion Holdings Ltd* [2023] UKSC 37 provides some clarity on the application of the deeming provision in section 471(3) of the Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**"), it also leaves various ancillary points considered in the lower courts unanswered. Difficult issues remain as to whether shares or options which were previously not treated as "employment-related" should now be re-considered in light of this decision.

Background

In 2006, Vermilion Holdings Ltd ("**Vermilion**" or the "**Company**") carried out a funding exercise as part of which Quest Advantage Limited ("**Quest**") was appointed to produce a business plan and financial projections and Dickson Minto was appointed as legal advisor to assist with the fundraising. Vermilion granted a "supplier option" to each of Quest and 22 Nominees Ltd (Dickson Minto's nominee) to acquire ordinary shares in the Company in consideration for the services provided by Quest and Dickson Minto.

The "supplier options" were not considered to be employment-related securities options within the meaning of ITEPA, s.471(5).

By January 2007, it transpired that the Company was not generating any income and was running out of working capital. Mr Noble (a director of Quest) highlighted that the Company needed another fundraising round to continue trading. The 2007 fundraising round had notable pre-conditions:

- to appoint Mr Noble as executive chairman of the Company; and
- to amend the "supplier options" held by Quest and Dickson Minto to reduce their respective share entitlements.

However, the Company did not vary the terms of the existing options, but instead granted each of Quest and Dickson Minto a new option on 2 July 2007. The option granted to Quest was now over F ordinary shares over a maximum of 1.5% of Vermilion's issued share capital. It was a condition of the new option that the 2006 option would lapse on the grant of the 2007 option.

Almost a decade later, in the context of a proposed sale of the Company, the 2007 option was novated by Quest to Mr Noble who then exercised the option. Shortly thereafter, Mr Noble and Vermilion sought confirmation from HMRC that the gain realised on the exercise of the 2007 option and sale of the resulting shares was subject to capital gains tax (rather than income tax/NICs). HMRC determined that the exercise of the option was a chargeable event pursuant to Part 7 of ITEPA and that the option gain therefore counted as Mr Noble's employment income for the purposes of ITEPA and, accordingly, HMRC assessed Vermilion to the resulting tax and NICs under PAYE (which Mr Noble had indemnified the Company for).

The relevant legislation

For the purposes of this appeal, the critical legislation is set out in ITEPA, s.471, which provides that:

"(1) This Chapter applies to a securities option acquired by a person where the right or opportunity to acquire the securities option is available by reason of an employment of that person or any other person.

(2) For the purposes of subsection (1) "employment" includes a former or prospective employment.

(3) A right or opportunity to acquire a securities option made available by a person's employer, or a person connected with a person's employer, is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person unless—

1. the person by whom the right or opportunity is made available is an individual, and

2. the right or opportunity is made available in the normal course of the domestic, family or personal relationships of that person."

Accordingly, there are effectively two tests set out in ITEPA, s.471, which, if either is satisfied, will result in the exercise of a securities option being subject to income tax rather than capital gains tax. The first test, in subsection (1), is a test of causation, asking whether the right or opportunity to acquire the securities option *"is available by reason of employment of that person or another person"*. The second test, in subsection (3), purports to eliminate the need to establish a causal link where a person's employer makes a right or opportunity to acquire a securities option available to the employee, in which circumstances the causal link is deemed to exist.

The lower courts considered and applied the tests set out in ITEPA, s.471 in a slightly different manner, thereby reaching a different conclusion each time but, in each case, either focusing on, or giving material weight to, the operative cause of the grant of the 2007 option. However, the Supreme Court's decision took a very different approach to the interaction of s. 471(1) and s. 471(3), determining in favour of HMRC on the basis that, once the deeming provision in s. 471(3) was engaged, there was no need to then qualify or test this by looking at the operative cause of the grant of the relevant option.

Appellate history

The First-tier Tribunal (Tax Chamber) ("**FTT**") held in the favour of the taxpayer. It determined that the scope of the deeming provision should be limited *"where the artificial assumption from deeming is at variance with the factual reason that gave rise to the right to acquire the option"*. It concluded that the grant of the 2007 option was 'made available' by Mr Noble's surrender of his 2006 option and he did not as a matter of fact acquire the 2007 option 'by reason of his employment' and accordingly the 2007 option should not be treated as an employment-related securities option.

The Upper Tribunal (Tax and Chancery Chamber) ("**UT**") overturned the decision of the FTT and held in favour of HMRC, finding that the FTT had erred in law. The UT decided that Mr Noble's employment (i.e. his directorship of Vermilion) was an operative cause of the grant of the 2007 option as it was a condition of the grant of the 2007 option that Mr Noble would become a director. As such, pursuant to ITEPA, s.471(1), the 2007 option was an employment-related securities option. Given this conclusion, the UT had no need to consider the application of the deeming provision set out in subsection (3) and did not do so.

The Court of Session Inner House, by majority, reinstated the FTT's decision, finding in favour of the taxpayer. It stated that the 2007 option had been made available by the existence of the 2006 option and that Mr Noble's directorship of Vermilion was not a sufficiently operative cause of the 2007 option being granted to engage ITEPA, s.471(1). Further, Lord Doherty considered that it would be *"anomalous, absurd and unjust"* to treat the opportunity to acquire the 2007 option as being made available by reason of Mr Noble's employment so as to engage ITEPA, s.471(3). The Court of Session further stated that it was an error to categorise ITEPA, s.471(3) *"as a separate and distinct route to taxation"* which is available even if it has been established that ITEPA, s.471(1) has no application (i.e. there is no direct causal link between the relevant employment and the option being made available).

Decision of the Supreme Court

The Supreme Court upheld HMRC's appeal, finding that the 2007 Option was an employment-related securities option. In a surprisingly short judgment, which leaves a number of key questions unanswered, the Supreme Court has given some direction on the interpretation of ITEPA, s.471(3) and the circumstances in which it applies. Lord Hodge, who gave the only judgment (with which Lord Lloyd-Jones, Lord Leggatt, Lord Burrows and Lady Rose agreed), stated (at [33]):

"… the purpose of section 471(3) is to circumvent the difficult issues that can arise in the application of section 471(1). The statutory provision makes it clear that if an employer makes available to an employee a securities option, that option will be treated in the employee's hands as an employment-related securities option and taxed accordingly."

It was noted that, in interpreting ITEPA, s.471, the lower courts had focused on the meaning of *"by reason of employment"* in subsection (1) to try to establish a

"causal" connection, thus requiring them to grapple with difficult questions of causation and, perhaps unsurprisingly, coming to different conclusions. Instead, the Supreme Court found that ITEPA, s.471(3) creates a straightforward 'bright line rule', being that if an employee is granted an option (or, more precisely, if the right or opportunity to acquire the option is made available) by their employer (or a person connected with the employer), that option is conclusively treated by ITEPA, s.471(3) as an employment-related securities option. That, in the view of the Supreme Court, reflects Parliament's specific intention behind the insertion of the deeming provision, i.e. avoiding the need for the courts to consider complex questions of causation raised by ITEPA, s.471(1) where the deeming provision in ITEPA, s.471(3) applies. Therefore, the only point on which the Supreme Court considered it necessary to opine, to determine whether HMRC's appeal should be upheld, was whether Vermilion (as employer) made the 2007 option available to Mr Noble whilst he was a director (and hence deemed for income tax purposes to be an employee) of Vermilion. The answer was, in the view of Lord Hodge, a rather simple yes on the facts and, as such, HMRC's appeal was allowed.

The Supreme Court cited with approval its previous guidance given in the case of *Fowler v HMRC* [2020] UKSC 22 on the application of deeming provisions in legislation. Lord Briggs in that case stated that:

"(1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
(2) For that purpose, the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
(3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.
(4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is completed to do so by clear language.
(5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real."

The *Vermilion* judgment removes any ambiguity in circumstances where an employee receives a share option which is made available by their employer (or a person connected with their employer). Given that Vermilion had granted the 2007 option at a time when Mr Noble was a director of the Company, the Supreme Court was satisfied that the option was made available to Mr Noble by his employer and therefore the exercise of that option rightly fell within the ambit of income tax.

Comment

The "who" test

In overturning the decision of the Court of Session Inner House, the Supreme Court decision tells us not to *"put the cart before the horse"*; the correct approach to applying the deeming provision in ITEPA, s.471(3) is to ascertain 'who' conferred the right or opportunity for the employee to acquire the share option in the employer company rather than 'why' that person conferred such right or opportunity. If the right or opportunity is made available by the employer (or a person connected with the employer), the option is correctly treated as being an employment-related securities option and, in those circumstances, there is no need to consider the (sometimes difficult) questions of causation posed by ITEPA, s.471(1). The Supreme Court opined that this sequencing in which the statutory provisions should be considered, and the consequent absence of any requirement to consider actual causation if the deeming provision in ITEPA, s.471(3) applies, reflects the intention of Parliament in enacting the deeming provision.

In dealing with this point, Lord Hodge stated (at [25]), *"That is what occurred in this case. The 2006 option was cancelled, not varied. Vermilion conferred a new option, over a different and new class of shares, on Quest. In so doing Vermilion fell within the deeming provision"*. The Court did not opine on whether the outcome would have been different if the terms of the 2006 option were varied instead of the Company granting a new option in 2007, but the implication from Lord Hodge's comments referred to above is maybe that it would have done. (It is, of course, a separate question as to whether an amendment to the number of shares and the class of shares would, as a matter of law, have amounted to a surrender and re-grant rather than a variation of the 2006 option in any event.)

The Supreme Court appears to have assumed that, if Vermilion granted the 2007 option to Quest, then it necessarily follows that Vermilion was the person which made the right or opportunity to acquire the 2007 option available to Mr Noble (in respect of whom it stated that Quest was a mere "nominee" – see further below on this nominee point). That will not always be the case (as is clear from the exception to ITEPA, s.471(3) which applies where the person who makes the right or opportunity is an individual. On the facts of *Vermilion*, it is far from clear that Vermilion (or any person connected with Vermilion) made such right or opportunity available to Mr Noble.

Absurd, anomalous, or unjust

Lord Hodge emphasised that, in determining whether the tests in ITEPA, s.471 apply, one should begin by seeking to apply the deeming provision in subsection (3) before trying to establish a causal link under subsection (1) and that the FTT and the Court of Session Inner House were incorrect in considering that the application of the deeming provision produced an *"absurd, anomalous, or unjust result"*. He states (at [33]) *"There is to my mind no anomaly, absurdity or injustice in giving effect to the deeming provision of section 471(3) in this case."* Unfortunately, what Lord Hodge did not address in any detail is his reasons for this conclusion; accordingly there is no clarity as to the circumstances which **may** create an anomalous, absurd or unjust result so as to prevent the application of the deeming provision in ITEPA, s.471(3). Clearly, one reason why the lower courts had grappled with this question was because the outcome did seem unfair. The inference from the Supreme Court must, however, be that the bar will be set quite high on this question.

The bank customer and employee

The Supreme Court referred to the case of *Price & Ors v HMRC* [2013] UKFTT 297 (TC) in which Judge Hellier gave a hypothetical example of a large bank making available to all its customers a securities option where some of such customers were also employees of the bank. Would that result in all options granted to customers, even those who were not its employees, falling within the deeming provision? It is clear from the judgment in *Price* that Judge Hellier was not considering whether the customers who were also employees would be caught by the deeming provision in subsection (3), he was merely concerned with the meaning of the words "*a* person's employer", as he goes on to state that:

"the purpose seems to us to be the provision of an automatic link to employment if the recipient of the opportunity is an employee and in other cases the requiring of an investigation as to whether or not there is in fact a link between the employment and the opportunity. As a result we regard (3) as limited to the making available of an opportunity to an employee by that employee's employer (or person connected with that employer)"

Lord Hodge considered that the decision in *Price* gives no support to the arguments put forward by Vermilion. The Supreme Court did not consider in detail the impact of the deeming provision on the options granted to those customers who are also the bank's employees, but the implication was clear that, by virtue of the deeming provision, those options would be employment-related securities options. That is notwithstanding the apparent anomaly and injustice (and possible absurdity) that the options granted to customers who are not employees would be taxed differently (and much more generously).

The "nominee"

The Supreme Court decision removes any ambiguity in circumstances where it is the employee which acquires a share option. However, one of things which is not clear from the decision is the application of the deeming provision if the right or opportunity to acquire the option is made available to someone else, including a person connected with the employee (not being the employee's nominee). Where an option is granted to a person connected with the employee (not as their nominee), it remains unclear whether legislation requires us to establish a causal link between the option and the employee's employment and determine whether the option was granted to the person connected with the employee 'by reason of [the employee's] employment'.

Current or former employment

Whilst it is now clear that one should apply the deeming provision under ITEPA, s.471(3) first to determine whether an option is an employment-related securities option, it should be noted that the application of the Supreme Court judgment is limited to a situation where the option holder is an employee. It arguably does not apply where the recipient of the option is a former or prospective employee as ITEPA, s.471(2) arguably only applies to the "causation test" set out in ITEPA, s.471(1).

Employment Related Securities

The Supreme Court decision in relation to ITEPA, s.471 will also apply to the same tests set out in ITEPA, s.421B which relate to acquisition of employment-related securities (where shares are acquired outright) given that the wording of ITEPA, ss.421B(1) and 421B(3) is for all practical purposes identical to ITEPA, ss.471(1) and 471(3).

Whilst the *Vermilion* judgment provides some clarity on the application of the deeming provision in ITEPA, s.471(3) and by extension ITEPA, s.421B(3), it also leaves various ancillary points considered in the lower courts unanswered. Employers are now having to consider whether shares or options which were previously not treated as "employment-related", whether on the basis of professional advice or otherwise, should now be considered to be "employment-related". We now wait in anticipation for HMRC's guidance to see whether any of the points considered in this article are dealt with in that guidance.

Other notable tax cases

Fisher and another v HMRC [2023] UKSC 44

The Supreme Court unanimously allowed the Fisher family's appeal in this transfer of assets abroad case. The Fisher family had been shareholders and directors in a UK close company, which transferred its entire betting business to a Gibraltarian company (in which the Fishers were also directors and shareholders) in the early 2000s, primarily as a way to avoid UK betting duty. HMRC assessed the UK resident Fishers to income tax under the transfer of assets abroad rules (in particular, the income charging provision), such tax being chargeable on the income earned by the Gibraltarian' betting company, in proportion to each of the Fisher's shareholding. Various issues of interpretation of the transfer of assets abroad code were heavily debated and disagreed upon as the case travelled through the courts – perhaps unsurprisingly given the often contradictory jurisprudence relating to one of the UK's oldest anti-avoidance provisions.

In the end, the Supreme Court opined on only one of those issues, namely whether the "transferor" who is subject to tax under the income charging provision must be the person who actually transferred the assets. Having decided that issue in the affirmative, the Court had to consider, if the legal person who transferred the assets was a company, whether a shareholder in that company could be a "transferor" in relation to that transfer. The Court found that a shareholder cannot be a "transferor" in relation to a company's assets – but left the door open for HMRC to argue that an individual may procure a transfer by other means. For example this may include the situation in which a taxpayer intentionally transfers assets into a UK company, as a "device", prior to the transfer of those assets to a person abroad. Shareholders in close companies will have been watching this case closely and may take comfort from the result, but should be wary of legislative updates to close what HMRC may now see as a gap in the statute.

Delinian Limited (formerly Euromoney Institutional Investor PLC) v HMRC [2023] EWCA Civ 1281

As noted in previous editions, there has recently been a renewed focus on "main purpose" tests. In this case, the main purpose test in question was that contained in section 137 of the Taxation of Chargeable Gains Act 1992, which prevents share-for-share exchange relief (also known as rollover relief) from applying where the exchange of shares is made as part of a "scheme or arrangements" having the avoidance of capital gains tax or corporation tax as a main purpose.

HMRC argued that the relief should be disapplied here as the taxpayer, Delinian, had initially agreed in principle to exchange its shareholdings in two companies for ordinary shares issued by a third party buyer, plus cash consideration, but it was subsequently agreed that Delinian would receive preference shares in place of cash. Delinian expected that rollover relief would apply in relation to the share exchange, and the substantial

shareholdings exemption would apply a year or more later when the preference shares were sold or redeemed.

HMRC unsuccessfully argued that the exchange of the shares formed part of a scheme or arrangement which had the main purpose of avoiding tax; such "arrangement" being the replacement of the cash consideration element with the preference shares. The Court of Appeal found that it was not a "natural use of language" to say that the entire exchange of shares for the ordinary and preference shares could form part of a scheme to replace the originally proposed cash payment with preference shares. Instead, the "scheme or arrangements" must be the whole of the scheme or arrangements taken by the taxpayer in question, not a selected part or parts of them. As a finding of fact, the FTT had found that the exchange (i.e. the actual scheme or arrangement in question) did not have a tax avoidance main purpose, and so rollover relief was not disapplied. This is a positive judgment for taxpayers, which sensibly considers the commercial motives behind the whole of the arrangement taking place.

Skatteforvaltningen v Solo Capital Partners LLP [2023] UKSC 40

The Supreme Court held that the "revenue rule" – a rule of private international law – did not prevent the Danish tax authority (Skatteforvaltningen or "**SKAT**") from seeking to recover money defrauded from it in the context of the "cum-ex" scandal. This involved refunds for Danish withholding tax, which SKAT alleged the defendants applied for and received, despite not owning shares in any relevant Danish companies nor receiving any dividends from such companies.

In order to recover the allegedly defrauded monies, SKAT brought claims against the defendants in the Commercial Court. As a preliminary issue before that court, the defendants successfully argued that the "revenue rule" applied. Also known as "Dicey Rule 3", the rule states that claims which seek to enforce the tax law of a foreign state, whether directly or indirectly, are inadmissible before courts in this jurisdiction.

The Supreme Court said that the revenue rule only applies to proceedings in which there is an unsatisfied demand for tax which foreign tax authorities seek directly or indirectly to receive. The Supreme Court therefore upheld the Court of Appeal's decision that the revenue rule did not apply in this case, on the basis that SKAT's claim in the context of its fraud litigation is not a claim for unpaid tax, nor were SKAT seeking to argue that the defendants cheated SKAT out of tax which it was due (in fact, there were no taxes due from the appellants in Denmark). Instead, SKAT was claiming as a victim of an alleged fraud for repayment of sums taken from it.

BCM Cayman & Anor v HMRC [2023] EWCA Civ 1179

The Court of Appeal dismissed the taxpayer's appeal in this case dealing with the taxation of "tiered partnerships" and whether loan interest incurred to invest in a partnership was deductible.

A UK limited partnership, BlueCrest Capital Management LP ("**UK LP**") carried on part of the trade of the BlueCrest group. Certain members of the UK LP wished to sell part of their interests in UK LP. The remaining members agreed to acquire those interests with a view to providing an "equity pool" for other members or employees of the group. A Cayman limited partnership ("**Cayman LP**") was formed in order to hold the interests of the buyers, with a newly incorporated Cayman company ("**Cayman Limited**") as general partner.

Cayman Limited entered into a loan with a third party lender, which became a corporate member of Cayman LP ("**the corporate member**"), in order to fund its acquisition. The sellers assigned their interest in UK LP to Cayman Limited and Cayman Limited contributed that interest to Cayman LP as a capital contribution. Under the relevant limited partnership deed, UK LP allocated profits to Cayman LP in priority to other partners. In turn, the partnership deed for the Cayman LP obliged it to allocate profits received from UK LP to Cayman Limited in priority to other partners. It also provided that if UK LP made profits above a certain level ("**super profits**") those profits were allocated to the corporate member.

There were two issues before the Court of Appeal: (i) whether Cayman Limited alone (and not the corporate member) was liable to corporation tax in respect of allocations of super profits; and (ii) whether Cayman Limited was entitled to tax relief in respect of its interest expense on the loan, on the basis that it was a trading loan relationship.

The Court held that Cayman Limited alone was subject to UK tax on the entirety of the superprofit allocation from UK LP to Cayman LP. It reached this conclusion on the basis that the corporate member was not a partner in UK LP and there was no legal principle that operated to make the corporate member a partner of UK LP, simply because it was a partner in Cayman LP.

The taxpayer had argued that, even if the corporate member was not a partner in UK LP, Cayman Limited should not be subject to corporation tax on the super profits allocated to it because it received those super profits as a fiduciary or representative of the corporate partner and not in its own right. This argument was rejected by the Court. Applying a *Ramsay* approach, the Court found that Cayman Limited's right to the super profits did not accrue in a fiduciary or representative capacity.

Importantly for the interpretation of the taxation of tiered partnerships more generally, the Court did not opine on the wider issue of whether partnerships generally give rise to fiduciary relationships between partners.

The Court also found for HMRC on the interest deductibility issue, finding that the general partner's loan costs were incurred for the purposes of its investment in the UK partnership, rather than for the purposes of the trade being carried on by the partnership. Therefore, the interest expenses were not deductible under the trading loan relationship rules.

Target Group Ltd v HMRC [2023] UKSC 35

In this VAT case, the Supreme Court held that outsourced loan administration services provided by the taxpayer were subject to the standard rate of VAT. The taxpayer argued that it was able to rely on the "financial services exemption" contained in Article 135 of the Principal VAT Directive, transposed into UK law by Group 5 of the Value Added Tax Act 1994 (and, in particular, the taxpayer relied on items 1, 2, 2A and 8). The taxpayer's services included maintaining loan accounts to record the financial relationship between the lender and its borrowers, for example recording payments and amounts of indebtedness, as well as operating bank accounts on behalf of the lender, which involved generating instructions for direct debit payments via BACS. Significantly, the taxpayer was not involved in the making of any loans at the outset or in making any further advances.

Importantly for providers of payment services, the Court held that the financial services exemption may only apply to a payment services provider where the services have the effect of transferring the funds and changing the legal and financial situation of the relevant parties. It is not enough for the provider to give instructions to make a payment, even if that instruction triggers or inevitably results in a payment or transfer. The taxpayer in this case was found to have a function which was limited to passing the necessary information to BACS, merely causing the payments to be made without making those payments and without assuming responsibility or liability for achieving the payments. Further, the taxpayer's services could not fall within the current account exemption, given the FTT's findings of fact that the loan accounts maintained by the taxpayer merely reflected "expected payments [which are] initially assumed to be made", meaning that they were no more than ledgers recording the effect of payments. It is widely accepted that the decision in this case represents a narrowing of the domestic interpretation of the financial services exemption.

HMRC v E.On UK PLC [2023] EWCA Civ 1383

The Court of Appeal allowed HMRC's appeal from the UT, in this decision relating to a "facilitation payment". The payment was made to members of the taxpayer's defined benefits pension scheme as part of an incentive package for employee members agreeing to proposed changes to that scheme. The question for the Court was whether, for income tax and NICs purposes, the facilitation payment comprised earnings (or remuneration) "from" employment. If it did, then income tax and NICs should be applied to the relevant facilitation payment. Whilst the direct subject of this litigation was a single facilitation payment on which income tax and NICs had not been deducted, HMRC agreed that if the taxpayer succeeded then it would refund the amounts deducted on all other payments.

The taxpayer primarily relied on the case of *Tilley v Wales* before the Court of Appeal, a case in which, broadly, employees were paid a sum to compensate them for giving up an existing right to a pension. However, the Court distinguished that case, finding that the changes to the pension scheme were to a retirement benefit relating to future services of the taxpayer, and not to accrued rights. As such, it was held that the payments were made to induce the employees to accept the changes to their pension scheme, and were "from" employment for income tax and NICs purposes.

HMRC v Bluecrest Capital Management LP & Ors [2023] EWCA Civ 1481

The Court of Appeal found for HMRC in this decision relating to a partner incentivisation plan. A company was made a partner of a fund management partnership and received a profit share that would previously have gone directly to individual partners. The company paid corporation tax on the profits and contributed the net amount back to the partnership as "special capital". Provided certain conditions were met, the company would in due course exercise a discretion to reallocate the special capital to the relevant individuals.

The Court rejected HMRC's argument that the profits allocated to the company partner should be treated for income tax purposes as the profit shares of the participating individual partners in the proportions in which they were intended to benefit from those allocations by final re-allocations of the special capital. However, the Court did accept HMRC's alternative argument, concluding that the special capital reallocated to the individual partners should be taxable as miscellaneous income (under section 687(1) of the Income Tax (Trading and Other Income) Act 2005), noting that it considered its economic substance to be that of deferred and contingent reward to the participating partners for their work.

Interesting decisions from the tribunals

UT sets aside direction that preliminary tax proceedings should be heard in private

In *HMRC v The Taxpayer* [2024] UKUT 12 (TCC), the UT agreed with HMRC that the FTT had erred in law when issuing a case management direction allowing preliminary proceedings in the taxpayer's appeal to be heard in private.

Background

The taxpayer's substantive appeal concerned the denial by HMRC of certain deductions which he had claimed for income tax purposes. The deductions which had been claimed were said to arise in relation to arrangements which has been challenged by HMRC and which were the subject of two other lead cases.

As well as applying to the FTT for his substantive appeal to be stayed behind those lead cases, the taxpayer made an application for various directions broadly to ensure that any proceedings would be heard in private and any decisions anonymised. The taxpayer argued that these directions were necessary to protect his private or family life, maintain the confidentiality of sensitive information, and avoid prejudice to the interests of justice.

The FTT granted the stay application, and also issued (amongst others) the following directions:

— that preliminary proceedings in the appeal should be heard in private (referred to as "**Direction 3**"); and

— that, shortly before the substantive hearing, both parties should provide representations on the taxpayer's application for anonymity (referred to as "**Direction 4**").

HMRC appealed the decision to issue Direction 3 on the basis that the taxpayer had not provided supporting evidence, and that Direction 3 failed to properly apply the common law principle of "open justice".

Decision

Direction 3 was made by the FTT pursuant to Rule 32 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the "**Tribunal Rules**"), the most relevant part of which states as follows:

"Public and private hearings

32. (1) Subject to the following paragraphs, all hearings must be held in public.

(2) The Tribunal may give a direction that a hearing, or part of it, is to be held in private if the Tribunal considers that restricting access to the hearing is justified-

(a) in the interests of public order or national security;
(b) in order to protect a person's right to respect for their private and family life;
(c) in order to maintain the confidentiality of sensitive information;
(d) in order to avoid serious harm to the public interest; or
(e) because not to do so would prejudice the interests of justice…"

The FTT noted that the starting point in tax cases is that all hearings must be held in public, as reflected in Rule 32(1) of the Tribunal Rules, citing Judge Bishopp in *Moyles v HMRC* [2012] UKFTT 541 (TC) (in turn citing a decision of the High Court) who emphasised that (at [14]):

"There is an obvious public interest in its being clear that the tax system is being operated even-handedly, an interest which would be compromised if hearings before this tribunal were in private save in the most compelling of circumstances."

In respect of any application for privacy under Rule 32(2)(a) to (d) of the Tribunal Rules, the FTT held that there will in practice be an onus on the applicant to produce cogent evidence. The FTT must consider such evidence and carry out a balancing exercise between the various Articles of the European Convention on Human Rights. In particular, there will often be a tension to be resolved between Article 6 (which provides a right to a public hearing, from which the applicant will be seeking a derogation) and Article 8 (which provides a right to respect for private and family life). In respect of an application under Rule 32(2)(e), the FTT must have rational and persuasive reasons for departing from the principle of open justice.

In this case, the only reason given by the FTT for making Direction 3 was that the preliminary proceedings should be heard in private to prevent the taxpayer's outstanding anonymity application regarding the substantive hearing from being futile (i.e. before being dealt with in accordance with Direction 4).

On that basis, the UT held that the FTT had erred in law and set aside Direction 3. The critical error made by the FTT was its conclusion that omitting to make Direction 3 would have rendered the application in relation to the substantive hearing futile, whilst also failing to consider whether Direction 3 was proportionate, taking into account its practical effect. The UT pointed out that, absent Direction 3, the taxpayer could have made an application for privacy/anonymity for the relevant preliminary proceedings, supported by evidence. Instead, Direction 3 purported to extend to all preliminary proceedings (including, for example, strike out hearings, which the UT considered would have been a significant derogation from the principle of open justice) with no explanation given to justify this blanket position.

The UT also firmly rejected a submission put forward on behalf of the taxpayer that the principle of open justice applies with any less force in the tribunals than in the courts, distinguishing the decision in *Cider of Sweden v HMRC* [2022] UKFTT 76 (TC), which had concerned an application by a third party for access to documents filed in a tax appeal but where there had been no prospect of a hearing in the near future.

Comment

At the time of writing, the UT's decision remains published only in anonymised form, pending any further appeal to be made to the Court of Appeal. In the interim, there has been furious speculation as to who the relevant taxpayer might be given the FTT's somewhat unusual initial decision.

This case usefully highlights that, while it is possible for tax cases to be heard in private and for judgments to be anonymised, such cases are rare. The general rule is that tax cases will be in the public domain and taxpayers should take this into consideration before entering into litigation (along with other key factors such as cost and the impact on management time).

Dyslexia diagnosis supports non-deliberate behaviour

In *Charles Collier and others v HMRC* [2023] UKFTT 00993 (TC), the FTT held that omissions from a taxpayer's returns had not been made deliberately, as alleged by HMRC, in circumstances where the taxpayer's dyslexia meant that he relied very heavily upon the services of an accountant to ensure that his returns were correct.

Background

HMRC's ability to make discovery assessments in respect of income tax or capital gains tax is subject to various conditions, including time limits. The general rule is that HMRC cannot make a discovery assessment more than four years after the end of the relevant tax year. That time limit is extended in certain circumstances, for example where the loss of tax was brought about "carelessly" (six years) or "deliberately" (20 years).

Deliberate errors will occur where a taxpayer knowingly provides HMRC with a document with the intention that HMRC should rely upon it as an accurate (see *Auxilium Project Management Ltd v HMRC* [2016] UKFTT 0249 (TC)). This is a subjective test and the courts will consider what the taxpayer's knowledge and intentions were at the relevant time. Deliberate behaviour may even include circumstances where a taxpayer deliberately shuts their eyes to issues which they suspect may exist (referred to as "blind-eye" knowledge or "Nelsonian blindness"). In *HMRC v Tooth* [2021] UKSC 17, the Supreme Court made obiter comments suggesting that deliberate behaviour may also include "recklessness".

In this case, the two appellants were Mr Collier as the individual taxpayer and a partnership in which Mr Collier and his wife were partners. The appeal concerned various assessments made by HMRC in respect of errors made in the taxpayer's self-assessment income tax returns and the partnership's tax returns, together with associated penalties. The fundamental issue before the FTT was whether the underdeclared tax had been brought about "deliberately" and therefore within HMRC's time limits for assessment.

While the taxpayer accepted that there were errors in the returns, he argued that this was the result of carelessness rather than any deliberate conduct. As accepted by the FTT in its findings of fact, the taxpayer had a diagnosis of dyslexia and a reading age of 12 years. Consequently, he relied upon the services of a small group of trusted professionals, including the preparation and submission of tax returns by a chartered accountant whom he had engaged for many years. However, following a personal tragedy, the accountant's standard of work had markedly declined, leading to problems with the returns and ultimately the accountant being replaced with new advisers.

Decision

HMRC argued that the returns in question contained deliberate errors because, as they alleged, the taxpayer had become aware that previous returns contained omissions caused by his accountant and therefore it should have been immediately apparent that there were likely also omissions in the later returns. However, the FTT did not consider that the evidence reliably demonstrated what the taxpayer knew or what actions they did or did not take. The FTT held that the taxpayer was not aware, at the time of submission, of the omissions in the tax returns.

HMRC also argued that the amounts involved were so significant that it would have been immediately apparent to the taxpayer that there were omissions in the returns. However, the FTT held that the amounts involved were not sufficiently significant in the context of the overall business of the taxpayer, while also taking into account the taxpayer's dyslexia diagnosis. The FTT was not satisfied, based on the available evidence, that the taxpayer had "blind-eye knowledge" of the omissions from his returns.

HMRC also argued that the taxpayer was "reckless" as to the accuracy of the returns, relying upon the remarks made by the Supreme Court as referenced above and citing various authorities which they submitted also referred to recklessness as a sufficient basis for determining that an error has been brought about deliberately. However, the FTT considered that the authorities relied upon by HMRC actually referred to blind-eye knowledge, not recklessness. In any case, the FTT determined that the taxpayer had not been reckless.

On that basis, the FTT accepted that the amounts omitted from the tax returns had been the result of carelessness rather than deliberate conduct, with the result that any assessments made more than six years after the end of the relevant tax year were time barred.

The taxpayer's alternative submissions around there being a lack of "discovery" therefore did not need to be considered. The taxpayer had also argued that the standard of proof for HMRC to satisfy should depend upon the seriousness of the allegations, with the bar to be set higher in this case given that HMRC's investigation in this case was conducted under Code of Practice 9 into suspected tax fraud. However, the FTT confirmed that the relevant standard of proof is the ordinary civil standard (i.e. on the balance of probabilities) rather than the higher standard for criminal cases (i.e. beyond reasonable doubt).

Comment

The limitations in the individual taxpayer's ability to properly review the information submitted in his returns appears to have played a key role in the FTT's decision in this case. Generally, taxpayers will be responsible for ensuring that their tax returns are correct and they can be held culpable for the actions of their advisers on that basis. It is also interesting to note that HMRC were content to make allegations of deliberate behaviour (i.e. civil fraud) in circumstances where they seemed to accept that omissions had been caused at least in part by the negligence of an adviser. The case therefore serves as a reminder to all taxpayers that tax returns should be properly checked as far as possible, even where professional advisers are engaged. Where allegations of deliberate or fraudulent behaviour are made, appropriate legal advice should be taken as soon as possible.

Artificial intelligence causes taxpayer to rely on fake cases

In *Felicity Harber v HMRC* [2023] UKFTT 01007 (TC), the FTT found that cases cited by a taxpayer in her defence were not genuine and had instead been generated by an artificial intelligence ("**AI**") system, such as Chat GPT.

Background

The taxpayer, Mrs Harber, disposed of a property without notifying her associated liability to capital gains tax. HMRC issued a "failure to notify" penalty, which the taxpayer appealed on the basis that she had a reasonable excuse due to a mental health condition and/or because it was reasonable for her to be ignorant of the law. In her written response, the taxpayer cited nine purported FTT decisions in which the appellant had been successful in showing that a reasonable excuse existed.

Unfortunately for the taxpayer, however, these were not genuine cases. Instead, they were cases which had been generated by AI, supplied to the taxpayer by "a friend in a solicitor's office".

Decision

The FTT noted that citing invented judgments causes the FTT and HMRC to waste time and public money, reducing resources available to progress other cases. It also said that the practice also "promotes cynicism" about judicial precedents and is a "serious and important issue". Somewhat curiously, however, the FTT added that this may be potentially less impactful in cases such as these than in other types of litigation given that the law on "reasonable excuse" is well-settled.

The FTT found as a fact that the taxpayer was not aware that the cases were fabricated and did not know how to check or locate case law authorities. In reaching its decision, therefore, the FTT indicated that it did not take into account the taxpayer's reliance on the AI cases. In other words, it reached the same decision as it would have done had she not provided the cases in her response.

On the substantive issue, the FTT concluded that the taxpayer's mental health condition did not amount to a reasonable excuse because it would not have prevented her from contacting HMRC and informing them of the sale and likely capital gains tax liability. It also concluded that her ignorance of the requirement to notify the liability was not objectively reasonable. The taxpayer's appeal was therefore dismissed.

Comment

This case illustrates one of the potential perils of using AI, emphasising the need to apply appropriate scrutiny to the results that it produces. AI may produce highly plausible but incorrect results by anticipating the text that should follow the input given. This is known as 'hallucination'.

Hallucination is one of the risk factors highlighted by the Solicitors' Regulation Authority ("**SRA**") in its Risk Outlook Report, 'The use of artificial intelligence in the legal market', dated 20 November 2023. Noting that it is "likely that these systems will become a normal part of everyday life, automating routine tasks", the SRA's report provides a number of recommendations regarding the use of AI. These include recommendations regarding accountability and governance, emphasising the need to supervise AI systems and those who use them to ensure that accurate results are produced.

Information notices requiring email searches can be valid

In *Parker Hannifin (GB) Ltd v HMRC* [2023] UKFTT 971 (TC), the FTT held that an information notice requiring the taxpayer to conduct a variety of searches across company emails was not for that reason invalid pursuant to schedule 36 to the Finance Act 2008 ("**FA 2008**"). However, the requirement to disclose all of the results from the searches was deemed too wide.

Background

The taxpayer, Parker Hannifin (GB) Limited, refinanced debt in June 2014 by issuing a £238m Eurobond to an LLP in the same group. In January 2017, the LLP transferred the Eurobond to another group entity and the taxpayer claimed tax relief on the interest paid on the Eurobond. HMRC thereafter considered whether to refuse relief pursuant to sections 441 and 442 of the Corporation Tax Act 2009 on the basis that the refinancing or transfer had an "unallowable purpose".

The specific issue before the FTT was the validity of an information notice issued by HMRC pursuant to schedule 36 FA 2008 (the "**Notice**"). The Notice required the taxpayer to carry out an email search using a list of specified search terms, such as "avoidance", and to provide all emails identified as a result.

The taxpayer engaged a professional adviser to carry out these searches, which produced over 11,000 results. The adviser therefore refined the results and found that only 1,695 were actually relevant to HMRC's investigation. These 1,695 emails were provided to HMRC, who responded on the same day (without even reviewing the emails provided) to request disclosure of all of the emails.

Decision

The FTT rejected the taxpayer's first ground of appeal that the Notice was invalid simply because it did not "specify" or "describe" the documents to be produced, and instead only contained search terms. This argument revolved around the case of *R (ex p Ulster Bank) v HMRC* [1997] STC 832 and the interpretation of predecessor legislation (namely s 20 of the Taxes Management Act 1970). The FTT held that *Ulster Bank* was highly persuasive, and thus in accordance with that judgment found that the protection of the taxpayer was not in the narrowing of the words "specify" or "describe", but that the documents identified must be relevant, or, more specifically, "reasonably required" (pursuant to schedule 36 FA 2008).

However, the FTT allowed the taxpayer's second ground of appeal, which was that the documents identified by the professional adviser as irrelevant were not "reasonably required" by HMRC and that the Notice should either be set aside or varied so only those documents identified as relevant by the professional adviser were in scope. The FTT held that the email searches required by HMRC produced results that were "far too wide"; for example, emails with the phrase "for the avoidance of doubt" were caught simply because they contained the search term "avoidance". The FTT agreed with the taxpayer that 3,648 emails about financing transactions and restructuring unrelated to the Eurobond, which HMRC claimed could provide "useful context" or "could be informative", amounted to a "fishing expedition".

Conclusively, the FTT held that, had the taxpayer appealed the Notice prior to the refinement exercise carried out by the professional adviser, the Notice would have been set aside altogether. However, the FTT also found as a fact that reliance could be placed on the exercise carried out by the professional adviser and noted that HMRC does permit third party professional firms to carry out exercises to identify relevant documents for disclosure to HMRC. On that basis, the FTT varied the Notice to exclude those documents already identified by the adviser as irrelevant. As the Notice (in its then varied form) had already been complied with, no further disclosure was required.

Comment

This case usefully highlights the extent of HMRC's investigatory powers, and the fact that this can in principle extend to email searches across a wide variety of search terms.

As often found in modern disclosure exercises, the use of search terms can throw up an excessive amount of incorrect hits as a result of a seemingly innocuous choice of words. Taxpayers who receive information notices from HMRC should carefully review the requirements and ensure that they take appropriate professional advice before disclosing any information, particularly before embarking on costly or time-consuming disclosure exercises.

HMRC refuse to withdraw case from FTT

In *Learna Limited v HMRC* [2023] UKFTT 00972 (TC), the FTT considered Rule 8(2)(a) of the Tribunal Rules as to whether an appeal should be struck out for a lack of jurisdiction.

Background

The taxpayer had filed an appeal against a decision made by HMRC in respect of its VAT affairs. Before the appeal could be heard by the FTT, HMRC withdrew their original decision and informed the FTT that the parties were in discussion to reach agreement on how to formally dispose of the proceedings.

HMRC subsequently informed the FTT that the parties were unable to reach such agreement and therefore applied for the FTT to strike out the appeal in accordance with Rule 8(2)(a) of the Tribunal Rules on the basis that:

- there was no longer an extant appealable decision; and
- as a result, there was no longer any issue over which the FTT could have jurisdiction.

Rule 8(2)(a) of the Tribunal Rules states that the FTT must strike out proceedings if it does not have jurisdiction in relation to those proceedings.

The taxpayer, on the other hand, argued that the appeal should be allowed by consent.

Decision

The FTT relied on the case of *Rasam Gayatri Silks v HMRC* [2010] UKFTT 50 (TC), deciding that the mere fact that a decision is withdrawn by HMRC after an appeal has been validly made does not necessarily mean that the FTT no longer has jurisdiction.

In support of the decision that the withdrawal by HMRC of an appealed decision cannot completely oust the FTT's jurisdiction, the FTT noted that, if the reverse were true, the FTT would have no jurisdiction to award costs against HMRC under Rule 10(1)(b) of the Tribunal Rules in circumstances where HMRC had acted unreasonably but withdrawn an assessment (i.e. meaning that HMRC could potentially escape costs awards).

The FTT therefore refused HMRC's application to strike out the appeal and invited HMRC to withdraw its case under Rule 17 of the Tribunal Rules or otherwise the parties to make a joint application for the appeal to be determined by consent under Rule 34 of the Tribunal Rules.

Comment

As noted by the FTT, Rule 17 of Tribunal Rules specifically allows HMRC to withdraw from proceedings. Although the general rule in the FTT is that neither party gets their costs paid by the other party, that general rule is subject to certain exceptions (notably where the case is "complex" or where a party has acted "unreasonably"). This is different from the usual position in civil court proceedings (or in the UT) where a loser will typically be ordered to pay a proportion of the winner's legal costs.

There was no suggestion on the facts in the judgment that the general rule in FTT proceedings regarding costs would be displaced had the appeal been allowed to run its course. On that basis, HMRC could have presumably sought to withdraw proceedings via Rule 17 without adverse cost ramifications. In any case, a consent order under Rule 34 can be drafted to make clear that no costs should be awarded (if that is indeed the agreed position between the parties). This decision serves as a useful reminder of the procedural complexities that can be involved in tax litigation and the importance of instructing legal counsel to help navigate taxpayers to an effective and efficient resolution.

Other developments

Pillar Two communications being sent to impacted taxpayers

HMRC have initiated a second OECD Pillar Two letter campaign targeting businesses potentially impacted by Multinational Top-up Tax (MTT) and Domestic Top-up Tax (DTT). The letters advise businesses to prepare for implementation and provide details on the new online service scheduled for release in spring 2024.

The HMRC online service will facilitate registration, filing returns, and making payments for MTT and DTT obligations. It is anticipated to become operational in stages, starting with registration and the ability to make payments on account by spring 2024.

An overview is provided on additional draft legislation which has been released since the implementing legislation in Finance (No.2) Act 2023, and draft guidance at both HMRC and OECD level. Businesses are encouraged to reach out to the Pillar Two HMRC team for assistance, should it be required, either through their Customer Compliance Manager or the designated contact.

Pandora Papers compliance activity

HMRC have initiated a second compliance response to the Pandora Papers, the release of offshore data by the International Consortium of Investigative Journalists. In June 2023, HMRC began sending letters to taxpayers named in the papers, urging a review of their tax affairs. A second tranche of letters was scheduled from December 2023.

The letters target individuals with suspected additional tax liabilities. Emphasising that penalties of up to 200% of tax due may be charged, the letters recommend recipients take professional advice in relation to any unclear tax positions. In relation to disclosure, the letters explain that the Contractual Disclosure Facility should be used in cases of deliberate behaviour or fraud, but that other routes such as the Worldwide Disclosure Facility may be used for non-deliberate offshore non-compliance.

Update on R&D compliance activity

HMRC have been progressing various workstreams in relation to improving R&D compliance. This includes:

- publishing Guidelines for Compliance, to provide clarity on HMRC's expectations of a valid R&D claim; and
- issuing new letters via the R&D Anti-Abuse Unit in response to claims which HMRC suspect have a high risk of being invalid.

HMRC have also confirmed their approach to using provisions in paragraph 16 of Schedule 18 to the Finance Act 1998 to correct returns to remove R&D claims. This power will be used where HMRC have reason to believe the claim is incorrect, and a letter will be issued to the claimant to assist them in understanding why the claim was rejected.

Improving R&D compliance has been a key focus in recent months. The extra compliance activities seem to be working, with HMRC noting a significant improvement in the "failure rate" for claims, which they claim has dropped from 45% to 15%.

New HMRC crypto asset disclosure facility

HMRC have introduced a new online disclosure facility for taxpayers to make voluntary disclosure in relation to any unpaid tax on income or gains from crypto assets, including exchange tokens like bitcoin, non-fungible tokens (NFTs), and utility tokens. The HMRC guidance outlines the eligibility criteria, registration process, required information, and how to calculate potential tax, interest, and penalties.

Online reporting from digital platforms – new rules coming into force

As widely reported in the press, on 1 January 2024, regulations came into effect which require certain UK digital platforms to report information to HMRC relating to the income of sellers of goods and services on their platform.

The regulations are based on the OECD's "Model Rules for Reporting by Platform Operations with respect to Sellers in the Sharing and Gig Economy". The intention is that the regulations will enable HMRC to exchange the information received with other participating jurisdictions (and as such HMRC will be able to access information from platforms based outside the UK).

Autumn Statement – compliance and administration measures

It was announced at the Autumn Statement that the Government will introduce tougher consequences for companies involved in the promotion of tax avoidance schemes. This includes the introduction of a new strict liability criminal offence for promoters who continue promoting avoidance schemes after receiving a Stop Notice, and a power enabling HMRC to pursue disqualification action against directors of companies exercising control or influence over companies involved in promoting tax avoidance.

Additionally, measures were announced to enhance the quality of HMRC data collection. Employers will be required to submit more detailed information on employee hours paid via Real Time Information PAYE reporting. Further, in their self-assessment tax returns, shareholders in owner-managed businesses will be required to specify dividend income received from their own company separately from other dividend income. The self-employed will need to provide information on the start and end dates of self-employment in their tax return.

VAT provisions relating to EU law

Measures are now in force which govern the way that VAT law is interpreted in light of Brexit and the Retained EU Law (Revocation and Reform) Act 2023 ("**REUL Act**"). The Government has always maintained that a "bespoke" approach would be taken to EU-derived VAT law (as opposed to other EU derived UK law), which would not be fully subject to the REUL Act. Draft legislation containing the "bespoke approach" was released for consultation last year and has been included in an amended form in the current Finance Bill. The provisions were provided with temporary statutory effect by the passing of the budget resolutions on 27 November 2023.

The provisions have been announced to provide "certainty" for taxpayers, by providing that EU derived UK VAT legislation should be interpreted in line with general principles of EU law. However, certain caveats apply. No UK legislation (primary or subordinate) can be quashed or disapplied by reason of incompatibility with EU law, and the authority of ECJ case law is subject to the same provisions in the REUL 2023. This means, for example, greater powers for the Court of Appeal and Supreme Court to depart from pre-31 December 2020 case law. Various recent statements by the Government are clear that they consider the provisions allow EU principles to apply only as an aid to interpreting UK legislation, and that, where a UK VAT provision conflicts with the EU legislation from which it derives, the UK legislation will prevail.

Latest HMRC nudge letter campaigns

The behavioural science of "nudge theory" has become an increasingly used weapon in HMRC's arsenal over the last decade or so – i.e. the idea that people can be better directed towards a desired course of action through suggestion rather than obligation. UK taxpayers may have noticed the same concept at work when completing their online tax returns, where certain information is now pre-populated based on figures held by HMRC (the idea being that the taxpayer will likely accept those figures by default). Over the last few months, HMRC have launched several new nudge letter campaigns on various issues, as summarised below.

Letters to agents regarding discrepancies in 2021/2022 self-assessment returns (October 2023)
HMRC are issuing letters to agents where discrepancies have been discovered in their clients' self-assessment returns for 2021/2022. The discrepancies relate to information submitted to HMRC by the client's employer or with Child Benefit information. Recipient agents are requested to review the relevant returns and to ensure that either the agent or their client makes a voluntary return. If this was done by 1 January 2024 (or another date agreed between the agent and HMRC), HMRC will not charge a penalty, but will consider doing so if this deadline is missed. The letter reminds recipients that statutory interest will always be due on late paid tax.

Pre-filing discussion for complex customers (October 2023)
HMRC have written to customers considered to have "complex" tax affairs, inviting them for a call with a Customer Compliance Manager prior to submitting their 2022/2023 self-assessment tax return. The letter recommends that recipients make use of the offer on the basis that this should reduce the likelihood of errors and any interest and penalties which may follow as a result.

Tax residence status (October 2023)
Ahead of the submission deadline for 2022/2023 returns, letters have been sent to taxpayers (and their agents) who declared non-resident status in their 2021/2022 returns, and who HMRC suspect were resident in the UK for that tax year. Recipients are asked to review their residence status for prior tax years and prior to filing their 2022/2023 return, and are directed to HMRC's online tax residence status checking tool.

Foreign Tax Credit Relief claims in relation to employment income (November 2023)
Those who claimed Foreign Tax Credit Relief in their self-assessment tax return for 2021/2022 have been sent letters to remind them of the conditions for the relief ahead of the deadline for 2022/2023 submissions. Recipients are directed to helpful online resources and are reminded to amend past returns should the relief have previously been claimed in error.

Hybrid business models and "Spotlight 63" (November 2023)
Taxpayers and agents who HMRC suspect have used tax planning arrangements using hybrid business models (also known as "Spotlight 63") have been sent letters which strongly advise them to disclose and withdraw from such arrangements, and correctly settle their tax affairs with HMRC. The letters state HMRC's view that the arrangements do not produce the purported tax outcomes (including the avoidance of mortgage relief restrictions, capital gains tax and inheritance tax), and are accompanied by a factsheet detailing the reasons for that conclusion. Recipients are warned that failure to disclose by 31 January 2024 may result in higher penalties being charged.

Incorporation relief claims (November 2023)
Letters have been issued to taxpayers who claimed incorporation relief from capital gains tax on the disposal of their property interests in the tax year 2017/2018. The letter claims that HMRC have information which suggests that the recipients claimed too much incorporation relief. Recipients are asked to check that they have calculated the relief correctly and, should an error be discovered, are provided with details of how to make a disclosure.

Use of money service businesses (November 2023)
Various letters have been issued to individuals who HMRC believe have used "money service businesses" to cash cheques or send money abroad during tax year 2022/2023. The letters are issued to those who have either not registered for self-assessment, or who have registered but who HMRC believe have underdeclared income on such returns. Recipients are reminded that, should they have used such businesses to send untaxed income abroad, or to cash cheques from untaxed income, such income should be declared on a self-assessment return and the appropriate must be tax paid, or else they will face penalties.

Taxpayers involved with Members Voluntary Liquidations (November 2023)
HMRC are sending letters to taxpayers who did not declare a distribution on their 2021/2022 self-assessment tax return but who held shares in companies which Companies House shows entered into a Members Voluntary Liquidation. Recipients are requested to review the relevant tax return, and to correct any errors by 31 January 2024, or risk HMRC opening a compliance check and raising penalties if an error is discovered.

Missing VAT returns (November 2023)
Taxpayers who have failed to submit one or more VAT returns are receiving letters from HMRC, asking them to submit any missing returns and pay their VAT bill, or risk assessments and penalties. If the recipient is no longer trading, it must inform HMRC and, if their VAT taxable

turnover falls below the required threshold, they may request HMRC to cancel their VAT registration. Letters have also been issued to agents asking them to review their customers' VAT compliance.

Tax relief on property repairs (January 2024)
HMRC are contacting taxpayers who they believe claimed too much tax relief on their property repair costs for the 2021-2022 tax year. The letter states that HMRC have data which suggests that the recipient's expenditure was higher than others with similar income. Recipients are reminded that only some improvements may be claimed as expenditure in the self-assessment tax return and that enhancements to the property may not be claimed. The letter provides examples of where expenditure may and may not qualify and states any amendments to the relevant return should be made by 31 January 2024.

Any taxpayers who receive nudge letters, even those confident of their tax position, should seek professional advice as soon as possible. Whilst nudge letters do not make specific accusations and are rarely overtly threatening in tone, they are generally based on actual data held by HMRC. Taxpayers who ignore these letters do so at their peril – failure to take action or respond is likely to mean that there is an imminent risk of HMRC starting an investigation (either under civil procedures or, in cases of suspected fraud, using their criminal powers). Early disclosure may also mitigate penalties.

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