[2016] UKFTT 0787 (TC)

TC05514

Appeal number: TC/2016/02522

PROCEDURE – whether validity of discovery assessment should be determined as a preliminary issue – no – application dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JANET ADDO **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at The Royal Courts of Justice, Strand, London on 23 November 2016

Julian Hickey, instructed by Reynolds Porter Chamberlain for the Appellant

Edward Leigh, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

1. The appellant has asked the Tribunal to direct that there be a hearing of a preliminary issue dealing with the validity of discovery assessments that HMRC made for the tax years 2009-10 and 2010-11. HMRC object to that application.

Relevant factual background

2. The relevant factual background was not in dispute.

3. In the 2009-10 and 2010-11 tax years, the appellant entered into arrangements that were disclosed under the provisions of Finance Act 2004 dealing with the disclosure of tax avoidance schemes ("DOTAS"). Similar arrangements were entered into by a number of specialist contractors who provided professional services to end users of those services. The essence of the planning was that, instead of billing end users for their services direct, the contractors entered into an employment contract with a company tax-resident in the Isle of Man ("AM Limited") with AM Limited billing the end users. AM Limited paid the contractors a relatively modest salary. It also established an employee benefit trust ("EBT") which made loans to the employees on advantageous terms. The contractors (including the appellant) argue that the income taxable under the arrangements is limited to the salary received together with an amount in respect of the beneficial loan arrangement (under sections 173 to 191 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003")). On the contractors' analysis, the full principal amount of the loans is not taxable income. By contrast, HMRC argue that the contractors are subject to tax on the full principal amount of those loans either because they are not loans at all (and so the principal amount of them is employment income) or because the legislation on the "transfer of assets abroad" in Chapter 2 of Part 13 of the Income Taxes Act 2007 ("ITA 2007") applies.

4. The form disclosing the planning under DOTAS contained the following sections:

> **Summary of proposal or arrangements**
>
> Non-resident company is established and centrally managed and controlled in the Isle of Man. This employs specialist contractors who work in a number of different industries. Non-resident company sponsors an employee benefit trust. Services of employees of off-shore company are provided to end users.
>
> Employees receive remuneration through the payroll subject to PAYE. Loan facilities are also offered by the EBT. EBT may also be used to provide other benefits.
>
> **Explanation of each element in the proposal or arrangements from which the expected tax advantage arises**
>
> Offshore company with no place of business in the UK is not subject to corporation tax.

> Creation by an offshore company of an EBT whose trustees are not UK resident has no UK tax implications.
>
> Contribution to EBT is deductible under Manx Law.
>
> Payment of salary to UK resident employees of off-shore company is subject to PAYE and primary NIC contributions.
>
> Benefits provided by EBT to UK resident employees are taxable in the UK under the benefits code. In particular loans provided to employees will be subject to the normal regime for employee loans.
>
> **Statutory provisions relevant to those elements of the proposal or arrangements from which the expected tax advantages arises**
>
> Offshore company CT status. TA 1988 s11
>
> Taxation of employment-related loans – ITEPA 2003 ss173-191
>
> Taxation of employment income – ITEPA 2003 Part 2 chapters 7 and 8.

5. In her self-assessment returns for both 2009-10 and 2010-11, the appellant quoted the scheme reference number ("SRN") that HMRC had allocated the planning under the DOTAS legislation. She also recorded that she received a benefit, which she quantified as £263 in 2009-10 and £1,024 in 2010-11, in respect of the beneficial terms of the loans she received from the EBT. She made no disclosure in the "white space" of either tax return.

6. HMRC did not open an enquiry under s9A of the Taxes Management Act 1970 ("TMA 1970") in relation to either tax return. However, they considered the planning was not effective and on 13 December 2013, they issued the appellant with "discovery assessments" under s29 of TMA 1970.

The application for determination of a preliminary issue

7. It was common ground that, in order for the discovery assessments to be valid, HMRC have the burden of proof on two issues. Firstly, they have the burden of proving that an HMRC officer made the requisite "discovery" for the purposes of s29(1) of TMA 1970. That is a subjective question that depends on the state of mind and knowledge of a particular HMRC officer. Secondly, HMRC have the burden of proving that the following condition (imposed by s29(5) of TMA 1970)[1] is met:

> at the time when an officer of the Board … ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A … the officer could not have been reasonably expected, on the basis of the information made available to him before

[1] At the hearing, Mr Leigh indicated that HMRC reserved their right to apply to amend their Statement of Case so as to argue that the condition set out in s29(4) of TMA 1970 was met owing to either carelessness or deliberate behaviour on the appellant's part. However, it was common ground that the appellant's application should be dealt with by reference to HMRC's case as currently pleaded which relies only on s29(5) and not on s29(4).

> that time, to be aware of the situation mentioned in subsection (1) above.

It was common ground that this second test in s29(5) imposed an objective test that should be approached from the perspective of a hypothetical HMRC officer.

8. The appellant has applied to the Tribunal for a direction that there be a hearing to address, as a preliminary issue, the following question:

> Were the notices of assessment, dated 13 December 2013, issued to the Appellant pursuant to section 29, Taxes Management Act 1970, validly made, in particular, were all the necessary considerations referred to in the said section satisfied in the circumstances of this case.

The law relating to the determination of issues as preliminary issues

9. It is clear from the decision of the Court of Appeal in *Hargreaves v Revenue and Customs Commissioners* [2016] EWCA Civ 174 that an appellant does not have an automatic right to have the issue of the validity of the assessments tested as a preliminary issue. However, it is also clear that the Tribunal has a discretion, as a matter of case management, to direct that an issue be determined as a preliminary issue. The Upper Tribunal has, in *Wrottesley v Revenue and Customs Commissioners* [2016] STC 1123 given guidance as to how this Tribunal should exercise its case-management discretion in paragraph [28] of the decision which reads as follows:

> We think that the key principles to consider can be summarised as follows:
>
> (1) The matter should be approached on the basis that the power to deal with matters separately at a preliminary hearing should be exercised with caution and used sparingly.
>
> (2) The power should only be exercised where there is a 'succinct, knockout point' which will dispose of the case or an aspect of the case. In this context an aspect of the case would normally mean a separate issue rather than a point which is a step in the analysis in arriving at a conclusion on a single issue. In addition, if there is a risk that determination of the preliminary issue may prove to be irrelevant then the point is unlikely to be a 'knockout' one.
>
> (3) An aspect of the requirement that the point must be a succinct one is that it must be capable of being decided after a relatively short hearing (as compared to the rest of the case) and without significant delay. This is unlikely if (a) the issue cannot be entirely divorced from the evidence and submissions relevant to the rest of the case, or (b) if a substantial body of evidence will require to be considered. This point explains why preliminary questions will usually be points of law. The tribunal should be particularly cautious on matters of mixed fact and law.
>
> (4) Regard should be had to whether there is any risk that determination of the preliminary issue could hinder the tribunal in arriving at a just result at a subsequent hearing of the remainder of the

case. This is clearly more likely if the issues overlap in some way—see (3)(a), above.

(5) Account should be taken of any potential for overall delay, making allowance for the possibility of a separate appeal on the preliminary issue.

(6) The possibility that determination of the preliminary issue may result in there being no need for a further hearing should be considered.

(7) Consideration should be given to whether determination of the preliminary issue would significantly cut down the cost and time required for pre-trial preparation or for the trial itself, or whether it could in fact increase costs overall.

(8) The tribunal should at all times have in mind the overall objective of the tribunal rules, namely to enable the tribunal to deal with cases fairly and justly.

Discussion and conclusion

10. I will not set out in full the respective arguments of the parties in the interests of keeping this decision brief, but will give an indication of the essence of them.

11. Mr Hickey submitted that a preliminary issue was entirely appropriate. He argued that the circumstances of this appeal are identical to those that the Upper Tribunal considered in *Charlton v Revenue & Customs Commissioners* [2013] STC 866 and in that case, the Upper Tribunal had concluded that the terms of disclosure of the planning under DOTAS would have been available to the "hypothetical officer" referred to in s29(5) and that, on the basis of the information available to the hypothetical officer, such an officer would have been reasonably expected to have been aware of the insufficiency of tax. He submitted that it would be simple to have a short hearing of a preliminary issue (lasting one or two days) at which little, if any, factual evidence would be needed. That hearing, in his submission, could focus on the attributes of a hypothetical officer and the conclusions such an officer could be expected to draw from the disclosure under DOTAS and the statutory provisions referred to in it. Dealing with the preliminary issue in this way would produce a "succinct knockout point" (at least if the appellant was successful) and so could obviate the need for a much longer hearing that had to deal with a much fuller body of law as well as contested facts.

12. Mr Leigh did not agree that the facts of this appeal were identical, or even similar, to those of *Charlton*. He argued that, in order for HMRC to discharge their burden on s29(5) of TMA 1970, they would need to establish (i) that there was an actual insufficiency in the appellant's self-assessment and (ii) why that insufficiency arose. They could only do that by establishing that the planning failed and so would need to rely on the full set of evidence (and make the same submissions) as they would make in a hearing of the substantive appeal. Therefore, he argued that consideration (3) as formulated by the Upper Tribunal should rule out the decision of a preliminary issue.

13. Mr Hickey submitted, by reference to passages in *Charlton* and *Sanderson v Commissioners for Her Majesty's Revenue and Customs* [2016] EWCA Civ 19 that it is not necessary for the hypothetical officer to have full details as to how a particular piece of planning works or to resolve difficult points of law and submitted that this demonstrated that a preliminary hearing could focus on a much narrower body of law and evidence than would be at issue in the substantive appeal. However, I do not believe that the passages that Mr Hickey referred to bear the weight that he seeks to place on them. If, as in *Charlton* itself, a court determines that a particular piece of planning is ineffective, and it is clear that a taxpayer has implemented identical planning, a hypothetical officer might well know that the taxpayer has not paid enough tax even if he or she does not understand how the planning is supposed to work or the detailed reasoning that led the court to conclude that it was ineffective. However, this only shows that there are situations where the detail of the planning may not matter. It is far from being a conclusion that the detail of the planning is necessarily irrelevant.

14. In order to succeed on s29(5), HMRC must show that the hypothetical inspector could not reasonably have been expected to know, from a certain defined corpus of information supplied of "the situation mentioned [in s29(1) of TMA 1970]". There was some discussion at the hearing as to what "situation" is referred to. I believe that it is clear from *Langham v Veltema* [2004] STC 544. That the "situation" referred to is an actual insufficiency in the assessment. However, I believe that Mr Leigh overstated matters when he argued that this meant that, to succeed on s29(5), HMRC have to show an actual insufficiency. All HMRC need to show is that, on the basis of the defined corpus of information, a hypothetical officer could not reasonably have been aware of the "actual insufficiency". Therefore, if for example, the only information presumed available to the hypothetical officer is the tax return itself which contains no information at all in the "white space" on how a particular piece of planning works and just includes numbers in the various boxes computed on the basis that the planning succeeds, it may be a straightforward matter for HMRC to succeed on s29(5). They may be able to succeed on s29(5) simply by demonstrating that the tax return contained no information other than a set of numbers and the numbers alone would not have alerted a hypothetical officer to the fact that the planning that resulted in those numbers was ineffective. No analysis at all of the underlying planning would be needed to make such an argument.

15. I therefore agree with Mr Hickey that there will be cases in which HMRC can discharge their burden on s29(5) without referring to the detail of a particular piece of planning. However, I do not believe that this is such a case. In order to succeed on s29(5), HMRC need to show that the contents of the disclosure to HMRC referred to at [4] which, following *Charlton* is part of the corpus of information presumed available to the hypothetical officer, would not have alerted the hypothetical officer to an actual insufficiency of tax. I believe that, in order to discharge that burden, HMRC will need to explain, at least in general terms, why they consider the "insufficiency" arises and why they do not consider that the DOTAS disclosure or the appellant's tax return would have alerted the hypothetical officer to that insufficiency.

16. In order to perform the task set out at [15], HMRC may wish to argue that matters vital to HMRC's analysis of why the planning fails were not mentioned in sufficient detail in the DOTAS disclosure. For example, it is clear from HMRC's Statement of Case that they consider that a highly relevant feature is that the arrangements were designed to act as a "conduit" to pass a particular amount of income to the appellant. The DOTAS disclosure does not suggest that AM Limited could be viewed as a conduit. If HMRC wish to argue that this omission would prevent a hypothetical officer from identifying an actual insufficiency of tax, they may wish to establish that there is at least some merit in the "conduit" argument as, if that argument were wholly without merit, a failure to mention it in the DOTAS disclosure might not be significant. That is an example only, but I believe it illustrates why, in the circumstances of this appeal, the s29(5) issue cannot be considered entirely separately from evidence and submissions relating to the substantive issue.

17. It follows from [14] to [16] above, that I do not believe that a consideration of issues relevant to s29(5) can be "entirely divorced" (to use the language of the Upper Tribunal in *Wrottesley*) from a consideration of the evidence or submissions relevant to the substantive appeal. I believe there would be a significant degree of overlap (although I do not agree with Mr Leigh that the overlap would be so significant as to require an examination of every substantive issue).

18. I have weighed up the other factors mentioned in *Wrottesley*. I acknowledge that, if the appellant succeeded on a preliminary issue, that would dispose entirely of the proceedings. Since I believe that a hearing of a preliminary issue would be shorter than the substantive hearing, there is at least a prospect that a preliminary hearing would save time and money. However, I believe that consideration is more than outweighed by the very real risk that a preliminary hearing will add to delay and expense by the Tribunal having to go over the same ground twice: once at a preliminary hearing and (if the appellant is unsuccessful) again at a substantive hearing.

19. I was told that a large number of taxpayers have implemented similar planning. Therefore, this appeal is likely to be a "test case" (at least in an informal sense: I am not suggesting that a direction under Rule 18 is necessarily appropriate). However, I do not think that affects matters: users of the planning who have not had enquiries opened may welcome a decision on a preliminary issue relating to s29(5) of TMA 1970, but users of planning who have received closure notices may prefer an earlier decision on the substantive issue. Therefore, having considered the overriding objective set out in this Tribunal's rules of dealing with cases fairly and justly, my decision is not to direct that there be a hearing of a preliminary issue in this appeal. At the same time as releasing this decision, I am making separate case management directions designed to set the entire substantive appeal on a path towards a hearing.

20. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

21.

JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 28 November 2016