Tax and the City Briefing for September

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Judicial Review

Several recent judicial review cases demonstrate the uphill battle taxpayers face in seeking to challenge actions taken by HMRC on public law grounds.

Accelerated Payment Notices (APNs)

Dickinson [2017] EWHC 1705 is the latest in a line of cases in which the exercise of HMRC's discretionary power to issue APNs has been challenged in the High Court. HMRC had agreed to postpone the payment of a disputed tax liability pending the resolution of the substantive dispute before the FTT, but then reversed the arrangements and issued APNs. The issue for judicial review was whether it was an abuse of power for HMRC to resile from its express promise not to enforce payment pending the resolution of the disputes relating to the validity of HMRC's assessments.

In this case, it was agreed by HMRC that a clear and specifically directed promise was made to the taxpayer to postpone the payment of the disputed tax. Even so, the High Court (Charles J.) rejected the taxpayer's claim on the basis that one of the purposes of the APN regime was to "change the goal posts", such that the reasonable grounds test for postponement of disputed tax is no longer determinative of the question where disputed tax relating to a DOTAS arrangement should lie pending determination of an appeal. Postponement agreements and clear promises are not ignored, but their force has been significantly undermined. In keeping with the general law on legitimate expectations, a change in macro political considerations was sufficient for HMRC to resile from its original promise.

The issuance of APNs and Partner Payment Notices (PPNs) has previously been challenged in *Rowe* [2015] EWHC 2293, *Walapu* [2016] EWHC 658 and *Vital Nut* [2016] EWHC 1797. In *Rowe* and *Walapu*, an argument was advanced that, despite HMRC making no express promise to the contrary, the issuance of an APN/PPN constituted a breach of a legitimate expectation. In *Vital Nut*, a related argument was made (also before Charles J.) that the APNs were issued in breach of the principles of natural justice and were unreasonable and unfair. None of the arguments were successful before the High Court.

In July, the Court of Appeal heard the joint appeals of *Rowe and others* (in relation to PPNs) and *Vital Nut and another* (in relation to APNs). The Court of Appeal decision is eagerly awaited.

Reversal of Mansworth v Jelley policy

In *Hely Hutchinson* [2017] EWCA Civ 1075, the essential question for the Court of Appeal was whether HMRC could resile from a position previously expressed in 2003 guidance. The taxpayer, RHH, had exercised share options in 1999 and 2000 and claimed additional losses in later periods based on guidance issued following the decision in *Mansworth v Jelley* [2003] STC 53. HMRC had rejected RHH's claim for these losses following a change of policy in 2009.

There was no question that HMRC had created a legitimate expectation. However, the Court of Appeal held that the level of unfairness was insufficient to meet the grounds for judicial review:

- There was no comparative unfairness in treating taxpayers with open returns

differently from those with closed returns – such taxpayers are in a materially different position, and in any event due weight must be given to the fact that a public body can change its policy if there is a good reason.

- Resiling from the guidance was not so unfair as to amount to an abuse of power – there was no "conspicuous unfairness" in HMRC removing guidance which was premised on a right which they did not, at the time of removal, consider existed.
- The decision to issue closure notices to reject the *Mansworth v Jelley* losses was lawfully taken – RHH was returned to the same position as he was in when he committed himself to the transactions which gave rise to the capital losses.

The use of judicial review in tax matters discussed before the CJEU

At a European level, the use of judicial review as a means to challenge tax legislation is also being met with disapproval. AG Campos Sanchez-Bordona has opined in *American Express v HMRC* (C-304/16) that parties cannot use the judicial review procedure unique to UK law to circumvent the route for challenging EU legislative acts. Whether the court will agree with the Advocate General's opinion remains to be seen; however, it is clear that there is little sympathy for applicants in judicial review cases where tax is concerned.

Corporate residence

The First-tier Tribunal's decision in the case of *Development Securities (No. 9) and others v HMRC* [2017] UKFTT 565 (14 July),is a useful reminder that simply going through the motions of having offshore board meetings is not of itself enough to achieve non-UK residence. The case also provides a useful summary of the relevant case law in the area and is a good indicator of the level of evidence required to defend a residence challenge.

The tax planning involved required companies to be Jersey resident for a period of time and then to become UK resident in order for the Development Securities Group to utilise latent capital losses. The FTT concluded that the Jersey companies were UK resident throughout so the tax planning failed.

It is unsurprising that the taxpayer lost because of the uncommerciality of the transaction the Jersey companies were asked to enter into (acquiring assets standing at a loss for a substantial amount in excess of their market value) and, consequently, the reliance that had to be placed on the UK tax resident parent, DS PLC for company law purposes.

Ordinary share capital

The Upper Tribunal in *McQuillan* [2017] UKUT 0344 overturned the decision of the FTT and allowed HMRC's appeal, holding that redeemable shares with no right to a dividend were "ordinary share capital" as defined in ITA 2007, s989. This meant that Mr and Mrs McQuillan did not satisfy the conditions for entrepreneurs' relief. The FTT had found in favour of the McQuillans that the right to no dividend is a right to a zero dividend and, as zero is a fixed rate, the redeemable shares held by the other shareholders did not count as ordinary share capital so the McQuillans satisfied the requirements for entrepreneurs' relief. The Upper Tribunal, however, did not agree with the FTT that the literal meaning of s989 is ambiguous. According to the Upper Tribunal, s989 is a bright line test – in order for a share to be within the excluded class there must be a right to a dividend. A zero rate of dividend does not give rise to a right to a dividend.

The Upper Tribunal's interpretation of "ordinary share capital" is consistent with the FTT's decision in *Castledine* [2016] SFTD 484 and both cases produced an unfair result for the claimants of entrepreneurs' relief. The Upper Tribunal acknowledged this but said it was not an unfairness that the Tribunal could correct. These cases both show how easy it is to fail to meet the conditions for entrepreneurs' relief and how any changes in

share capital for commercial reasons should be carefully thought through to avoid tax traps. If the redeemable shares had carried a fixed nominal dividend, the shares would not have been ordinary share capital. The Upper Tribunal sympathised with the McQuillans but the unfairness could not be corrected by the Tribunal – only by a change in the legislation.

This decision is also relevant to other provisions that refer to the s989 definition of “ordinary share capital” and that count up the percentage of ordinary share capital held by a particular person – for example in the context of group relief or stamp duty group relief.

What to look out for:

- On 30 September, the two new corporate offences of failure to prevent facilitation of tax evasion, one in relation to UK taxes and the other for foreign taxes, contained in Part 3 of the Criminal Finances Act 2017 come into force. The final version of HMRC’s guidance was published on 7 September, followed on 8 September by the Law Society’s industry-specific guidelines. UK Finance (formerly the BBA) is also expected to publish guidance.

- 22 September is the closing date for the consultation on financing growth in innovative firms. This consultation includes a review of the effectiveness of the various tax reliefs currently available to investors and also looks at how investment originating from pension funds can be increased.

- 25 September is the deadline for comments on the draft guidance for reform of CT loss relief which were published on 31 July.

- The Large Business Risk Review was originally promised before the summer parliamentary recess but has not appeared yet. In his response to the OTS on its report on the simplification of the corporation tax computation, Philip Hammond encourages the OTS to engage with this consultation on the risk profiles of large business and promoting stronger compliance, promising that opportunities to promote taxpayer certainty will be explored as part of this consultation.

- We still await the consultation on the tax implications of the IFRS 16 leasing changes which was expected in the summer.

- The extension of the VAT disclosure regime to all other indirect taxes and its alignment more closely with DOTAS was supposed to have had effect from 1 September 2017. However, due to the general election the measure was not enacted in the Finance Act 2017. Finance (No.2) Bill 2017 published on 8 September provides it will now come into effect on 1 January 2018.

- Revised HMRC guidance on the penalties for enablers of defeated tax avoidance schemes legislation to be enacted in the Finance (No.2) Bill 2017 is expected shortly.

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