AAT Tax Update 22 October 2013

In this week's edition of the tax update we look at:
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1. MORI fails to get costs after successful tribunal case

The process of litigation can be expensive both in terms of the legal fees incurred but also because it can divert a lot of a business' resource away from the business activity.

In Market & Opinion Research International Ltd v Revenue & Customs [2013] UKFTT 475, MORI sought costs on the grounds that HMRC acted unreasonably in conducting and defending proceedings. The costs are in relation to an appeal in the standard category lodged on 9 September 2010. The substantive issue in the proceedings related to a *Fleming* claim for VAT input tax of £126,454.22 for periods ended between 1 January 1986 and 30 April 1997 on the fuel element of mileage allowances reimbursed to researchers engaged by the appellant.

MORI's complaint is that there was essentially no new information or evidence provided to HMRC at the hearing that they did not have before. They say HMRC did not engage with the submissions and evidence provided by the appellant prior to the hearing, and that if they had done so the case would have settled much earlier in the proceedings. The appellant also points to various other matters, as amounting to HMRC unreasonably conducting and defending proceedings including the fact that HMRC raised the jurisdiction issue late in the proceedings on a misconceived basis.

HMRC had abandoned the appeal after 2 days. Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Tribunal Procedure Rules") provides as follows;

> "10. – (1) The Tribunal may only make an order in respect of costs (or, in Scotland, expenses) –
>
> (a) …
>
> (b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings;…"

HMRC say that the relevance and significance of various documents in particular the 1995 Researcher Handbook was not adequately explained to them. In particular it did not appear to provide evidence that the input tax on the mileage had not been claimed. They say it was only after the explanation from the Tribunal's question as to how this assisted the appellant's case that HMRC appreciated the appellant's contention.

Pausing at this point and reflecting on some 35 years' experience I can sympathise with what HMRC are arguing. Over the years I have seen many cases in which one party failed to communicate the strength of their arguments and it was only at a late stage that a decision could be made.

Communication is a two way process and in practice information can be presented but the listener does not understand it. This is not acting unreasonably.

This case should never have been allowed to get to the Tribunal. If MORI had been better at communicating the facts and arguments it could probably have been resolved earlier. I think that the internal review process conducted by HMRC deserves to be criticised but the failure to communicate effectively involves both parties.

Alternative dispute resolution (ADR) might have helped avoid the tribunal hearing the appeal by the facilitator helping each of the parties appreciate the others' arguments supporting the contention.

However, HMRC had not acted unreasonably as they had not understood the strength of MORI's arguments until the hearing began. . MORI were not entitled to recover their costs.

2. HMRC unable to enforce discovery assessments because it had all the information

Ever since the Veltema decision, delivered by the Court of Appeal in 2004, which changed the law and demonstrated that the certainty intended to follow full disclosure, was illusory, there has been an obvious need to amend s29 TMA 1970. The right thing to do would be to reinstate the protection which was intended to give certainty to taxpayers. The problem is the lack of political will to correct the defect. That defect enables HMRC to assess tax years which would otherwise be out of date.

In **Michael Freeman v Revenue & Customs [2013] UKFTT 496**, HMRC had issued discovery assessments to recover significant amounts of tax which ought to have been paid. There is no dispute that Mr. Freeman owes capital gains tax of £404,702.80 plus interest if HMRC are entitled to raise discovery assessments.

Mr. Freeman is a commercial property developer and founded, with his brother, a company which became Argent Group plc ("AG"). In August 1997 he was the registered holder of 969,990 shares in AG ("AG Shares"). These were exchanged for 3,637,462 Loan Notes.

The swopping of the AG Shares for Loan Notes was the subject of a clearance with the Inland Revenue pursuant to s.138 TCGA on 10 July 1997 and the clearance was given on 12 August 1997.

The acquisition of the Loan Notes was mentioned in the "additional information" section of the tax return (the "1997/1998 White Space Disclosure") which stated:

> "On 1 August 1997, I sold [the AG Shares]. The consideration received consisted of [the Loan Notes]. S.135 TCGA 1992 applies to this transaction and therefore it has not been reported on the CGT pages of this tax return."

In 1998/99 the Mr Freeman redeemed £235,000 of the Loan Notes at par. He redeemed a further £800,000 worth of Loan Notes at par in 1999/2000. The redemptions were included on the Appellant's tax returns for the relevant years. Taper relief was not claimed in respect of the 1998/99 and 1999/2000 redemptions because the Loan Notes did not, at that point, qualify for taper relief.

In December 2002, the Mr. Freeman redeemed at par the remaining Loan Notes, worth £2,602,462. Taper relief was claimed in relation to the December 2002 redemption of Loan Notes because, if they had not been qualifying corporate bonds, they would have at that point qualified for taper relief on the grounds that they would have become business assets with effect from 6 April 2000.

In 2000, HMRC had written agreeing that the loan notes were non qualifying corporate bonds so Mr Freeman was surprised when a discovery assessment was made into his 2002/3 returns as he understood that the legal status of the Loan Notes had been agreed with HMRC.

At all times Mr. Freeman made full disclosure of all his tax affairs to HMRC. So HMRC did not have any new information on which they might make a discovery. HMRC just changed its mind.

The disclosure that the Loan Notes being non-qualifying corporate bonds was made in the tax return because it was crucial to the claim for taper relief which was being made by Mr. Freeman. If the Loan Notes had been qualifying corporate bonds no taper relief would have been available on redemption in 2002/03.

So Mr Freeman's argument was that because he had made a full and honest disclosure of his position, HMRC simply needed to read the Tax Return and they would have realised that the Appellant's position was that the Loan Notes were not QCBs. The disclosure in the Tax Return of 2002/3 notified HMRC of this position. The Tax Return was simply informing the Respondents of a matter already agreed between them (i.e. that the Loan Notes were not QCBs). HMRC sat on the information and as time passed they could only challenge 2002/03 using the discovery provisions but s29(5)&(6) gave the taxpayer protection if the disclosure was sufficient to make HMRC aware of the claim being made in the return.

HMRC can make a discovery assessment if a hypothetical officer could not have been reasonably expected, on the basis of information made available to him before the expiry of the enquiry window or closure of the enquiry, to be aware of the relevant situation, which justifies the making of the assessment.

There is no question that the Loan Note and letter of 3 April 2000 were made available to HMRC within the meaning of s.29 (6). The information provided in 2000 was information provided in writing to the Board on behalf of the taxpayer and had the hypothetical officer considered it, he could reasonably have been expected to become aware of the insufficiency to which it pointed before 31 October 2005.

An officer in HMRC looking at the return in 2002/3 would know that the statement in the return that the Loan Notes was not a QCB was at odds with the instrument itself and that since the final redemption date fell in 2002/3 and that such an event had occurred in that year, there was likely to be an insufficiency of tax.

The Tribunal ruled in favour of the taxpayer. HMRC were not allowed to collect the tax charged in the discovery assessments because HMRC had not made a discovery. They had all the information to have raised an assessment in good time but when they missed the deadline, they lost the right to collect the tax.

3. HMRC Publish the tax gap figures for 2011/12

The estimates just published for 2011-12 show the tax gap is £35 billion, which takes into account the money HMRC brings in through its compliance activities.

According to HMRC most small and medium-sized enterprises (SMEs) pay the right amount of tax. But HMRC estimate that the SME customer group is responsible for nearly half of the value of tax gap. Much of this is attributable to error or failing to take reasonable care. HMRC provides a wide range of tailored and targeted educational support to give customers greater certainty that they have got things right at key points in their business lifecycle.
The two page brief is worth a read and can be accessed here.

4. Cabinet reshuffle introduces new faces at the Treasury

In tax, the only constant is change. Just when I think that a treasury minister is managing to get a grip on their brief, it seems that politicians decide to change things and the recent reshuffle was no exception. David Gauke remains as Exchequer Secretary.

Greg Clark has lost his post as Financial Secretary and been replaced by Sajid Javid who was previously the Economic Secretary, Nicky Morgan replaces Sajid Javid as Economic Secretary to the Treasury.

5. Consultation on simplifying the filing of information at Companies House

At 49 pages in length, **this consultation is worth a read** and AAT would welcome your comments on the questions it raises. Where the directors and shareholders are the same people, it is suggested that the requirement to make the company registers available to the public at the Registered Office could be removed, because the information held on the public register and the company registers are identical. The objective is to reduce the burden on small companies.

The government seeks a response by: 22 November 2013 to be sent to:
Company Law Simplifications Team, BIS, Spur 2, Level 3, 1, Victoria Street, London SW1H 0ET
Tel: 020 7215 3342
Email: **CompanyFilingReqts@bis.gsi.gov.uk**

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