A better alternative just around the block?

Hugh Gunson and Guy Bud explain the experiences of start-up Fashion on the Block after in inadvertently filed the wrong form with HMRC – and it makes for sober reading.

Everyone knows how it feels to discover that they have made a really big mistake. The stomach drops. How could this have happened? Then, amid the incomprehension and anguish, you begin to think desperately about whether it can be undone.

Rectification is available in a tax context, where mistakes can be very big and costly indeed, when something has been done by the parties which did not reflect their intention and/or have the desired tax effect. It is a particularly powerful remedy, as it can effectively undo the mistake and the related tax consequences with retrospective effect. But it is also a closely guarded one. As one of a number of equitable remedy, it is the province of the High Court, where even a straightforward and uncontested application can seem beyond the means of many taxpayers.

No wonder, then, that the prospect of essentially gaining the same remedy in a tax appeal before the First-Tier Tribunal ("FTT") seems particularly appealing. There are indications in past judgments which suggest that the FTT may have jurisdiction to determine a taxpayer's tax position on the basis that the High Court would have granted such an equitable remedy (even though it is accepted that the FTT cannot itself actually grant the remedy). As a result, there is much to interest in the recent decision in Fashion on the Block Ltd v HMRC [2021] UKFTT 306 (TC).

Background

The facts of the case were, it is fair to say, pretty exasperating. Fashion on the Block is a nascent start-up which runs an app called 'Little Black Door'. The idea is that users keep records of their purchases of clothes and items and use the app to trade or loan them to others to avoid waste. In the hope of raising money to commercialise this venture, its founder sought to raise seed capital. In order to make the shares attractive to potential investors, the company sought to make sure that these investors would be able to benefit from the Seed Enterprise Investment Scheme ('SEIS') under Part 5A of the Income Tax Act 2007.

The company duly applied for SEIS advanced authorisation from HMRC. It was not long, however, before confusion became apparent between SEIS and the similarly named and related Enterprise Investment Scheme ('EIS'). HMRC responded to the company's application by giving advance assurance for both SEIS and EIS. The next step was for the company to complete and send HMRC a "compliance statement" once the relevant shares had been issued. Although it was always apparent that the company was applying for SEIS, it accidentally downloaded and submitted Form EIS1 (the compliance statement for EIS) rather than Form SEIS1 (the compliance statement for SEIS). There was, in fact, very little difference between the two forms in practice. The vast majority of the information required for Form SEIS1 was included (or could be inferred) from the information included on Form EIS1. If the right form had been completed and submitted, there was also no dispute that

the company's shares would have been eligible for SEIS. As it had received form EIS1, HMRC responded by issuing form EIS2 authorising the company to issue certificates to investors entitling them to claim EIS relief. The mistake was realised almost immediately and the key issue, therefore, was whether anything could be done to remedy it.

HMRC refused to exercise its statutory discretion in the taxpayer's favour. It insisted, in effect, that the two forms were materially different and that it was bound to conclude that SEIS was not available because Fashion on the Block was technically party to a prior EIS investment due to the submission of Form EIS1 and could no longer be a 'qualifying company' for SEIS. While this seems like a very literal interpretation of the rules, it does reflect HMRC's general approach to SEIS, EIS, and similar reliefs, where a very strict approach is typically applied to determining whether the relevant conditions are satisfied.

This raised two issues for the FTT. Could a pro forma document like Form EIS1 actually be rectified in the way the taxpayer urged and, more urgently, did the FTT have any jurisdiction to consider this anyway?

Lobler and 'Incidental' Rectification

As mentioned above, the default position is that any remedy arising from an equitable doctrine can only be granted by the High Court. This is not an entirely immutable rule, however. Proudman J in the Upper Tribunal ('UT') stated in Lobler v HMRC [2015] UKUT 152 (TCC) that "although the FTT did not itself have powers to order rectification, it could determine that if rectification would be granted by a court who does have jurisdiction to grant it, Mr Lobler's tax positions would follow as if such rectification had been granted."

Lobler was, of course, an exceptional case in many ways. It concerned a taxpayer who had, unwittingly, ticked the wrong box when withdrawing funds from a life assurance policy. By operation of the part-surrender rules, he was left facing a tax bill in excess of 700% in what, the FTT openly conceded, was an "outrageously unfair result".

In order to reach the obviously desirable conclusion, Proudman J pointed to the fact that it was long-established that the FTT could take into account the availability of specific performance without any suggestion that "the appellant must go to court and actually obtain the remedy of specific performance". After all, the maxim is that equity regards as done that which ought to be done. In essence, she allowed Mr Lobler's tax position to be determined in a tax appeal before the FTT by considering whether rectification would be available on the facts.

Subsequent cases

As UT authority, Lobler was relied upon heavily in Hymanson v HMRC [2018] UKFTT 667 (TC) in the context of the equitable remedy of rescission (setting aside) on grounds of mistake. The case concerned a builder who had forfeited his fixed protection by inadvertently continuing to make small payments into a registered pension scheme. In his appeal before the FTT, among other things the taxpayer argued that the offending payments could be set aside on grounds of mistake and this fact should be used to determine his tax position. It was submitted in its statement of case that "HMRC do not consider that the FTT is an

appropriate forum for consideration of mistake-based arguments" and explicitly suggested that Lobler had been wrongly decided.

The FTT, nonetheless, sided with the taxpayer and determined that "Mr Hymanson would be entitled to rescission if he was to take his case to the High Court and that his tax position should therefore be determined as if the remedy had been granted." It is understood that HMRC appealed but the matter never reached the UT because the High Court did, in fact, order rescission on the basis of separate claim by the taxpayer.

HMRC continue, however, to strongly resist the idea that the FTT has any jurisdiction to hear such arguments on the applicability of equitable remedies. Tribunal Judge McNall heard submissions to this effect as part of the procedural hearing in Wesley and others v HMRC [2019] UKFTT 259 (TC) and set out his reflections on the issue: "On the face of it, the issue of jurisdiction per se is a binary 'bright line' issue. It is not a matter of discretion. I am reminded that the Tribunal, and its judiciary, are creatures of statute, and, unlike the High Court, there is no 'inherent' jurisdiction. Hence, and as a matter of positive law, this Tribunal cannot choose whether or not it has jurisdiction – it either has jurisdiction to decide a matter or it does not. Jurisdiction cannot be conferred by consent, or (for that matter) a misunderstanding or a mistake (whether unilateral or shared) as to the scope of its jurisdiction. However, this to some degree obscures the (perhaps different) question as whether the Tribunal's jurisdiction (even though flowing from statute) is protean—in the sense that it can nonetheless develop and lend itself to newly-emerging scenarios."

This raises more abstract issues around the nature of the FTT, also perhaps relevant to its much disputed public law jurisdiction, which have far-reaching implications but are yet to be resolved satisfactorily. HMRC, it would seem, have taken a clear contrary position.

Fashioning a remedy

This brings us back to Fashion on the Block. On hearing arguments from the parties, neither of which was represented by Counsel, the FTT concluded that it was necessary to take a 'realistic' view of the facts when applying tax statutes under the rule in Barclays Mercantile Business Finance Ltd v Mawson [2004] UKHL 51 and, effectively, applied a 'reverse' Ramsay doctrine in the taxpayer's favour. As a result, it determined that the taxpayer had not in any realistic sense become party to a prior risk capital scheme investment simply by completing Form EIS1 and that SEIS, accordingly, remained available.

The FTT did, however, proceed to address the issue of rectification and concluded 'on the alternative basis' that it would indeed be available. In many ways, it skated over the issue of jurisdiction altogether with little more than a nod to the principles 'clearly explained' in Lobler. It concluded that it would also be possible to rectify Form EIS1 which provided 'nearly all the information required by the SEIS legislation' and that it was possible easily to identify the omissions. In reaching this conclusion, the FTT's reasoning was rather curious and there is some doubt whether it correctly applied the test for rectification.

In particular, it gave little focus to what the specific intentions of the taxpayer had been at the time (as is required for rectification), beyond a general intention to fill out Form SEIS1. Indeed, it might also be argued that the FTT skated a little too quickly over some of the

practical considerations about the form of rectification that was actually required. These points would no doubt be explored further on any appeal – although it is unclear at the time of writing whether the case will proceed further.

Conclusion

As a basic point, this case is a reminder that when faced with an unexpected tax liability, taxpayers should always consider whether some form of equitable remedy might be available to relieve or mitigate it. Rectification was in point in Fashion on the Block, but in recent years we have also seen an increasing number of cases where transactions leading to adverse tax consequences have been set aside on grounds of mistake.

On one view, it is encouraging to see the FTT reaffirming that it has jurisdiction to consider the availability of rectification in spite of sustained pressure from HMRC. For now, it seems that there is still life left in the Lobler principle—in at least the most egregious of cases. However, it is clear that HMRC have not yet accepted the jurisdiction position. When faced with an argument on equitable remedies in the FTT, they will likely seek to challenge both the availability of the remedy itself and the issue of jurisdiction. They may well also seek to appeal any successful decision to the UT and, potentially, even beyond. It remains to be seen how a higher court will approach the jurisdiction issue in a case less extreme than Lobler. By contrast, in our experience HMRC often do not seek to oppose (or even participate in) rectification or mistake applications in the High Court which do not arise from failed avoidance schemes. This will create a dilemma for many taxpayers considering their options.

From a practical perspective, we consider that many taxpayers will find it safer and less costly to proceed directly to the High Court rather than becoming embroiled in appeals which may conclude with the determination that such an application is, in any case, necessary. Contrary to assumptions, the FTT will not always be the best option.

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