The ‘likely’ lad: what’s in a word?

Israr Manawer highlights a case where a follower notice was quashed after a Judicial Review outcome was overturned by judges.

A recent Supreme Court ruling has highlighted the difficult line trodden by taxpayers who decide to challenge HMRC’s opinion that they are not entitled to the tax advantage conferred by entering into a particular tax arrangement.

Indeed, the Supreme Court’s introduction to its judgment describes the follower notice regime as ‘draconian’ and ‘raising the stakes on tax avoidance’.

In this case, the taxpayer, Mr Haworth, had challenged HMRC’s issuing of a follower notice and accelerated payment notice, claiming that he was entitled to the tax advantage and that HMRC was wrong to base its opinion on a previous case (Smallwood) as the situation was different.

The Supreme Court ruled in favour of Mr Haworth, upholding a previous ruling by the Court of Appeal to quash the follower and accelerated payment notices, thus overturning the outcome of a Judicial Review, which had found in favour of HMRC.

Background to the case

Mr Haworth had created a family trust with trustees based in Jersey and Mauritius. The trust sold the shares of a company floated on the London Stock Exchange so, in order to avoid paying capital gains tax (CGT), the Jersey-based trustees resigned, leaving the Mauritian-based trustees in place. This enabled the trust to take advantage of the double taxation relief which meant that there was no CGT payable in Mauritius.

HMRC viewed these arrangements as sufficiently similar to another case, Smallwood, also involving CGT relief in Mauritius, to warrant opening an enquiry into Mr Haworth’s tax return in which he disclosed the arrangement he’d entered into.

In Smallwood, the Court of Appeal had ruled in favour of HMRC, deciding that the ‘place of effective management’ (POEM) of the trust concerned was the UK and not Mauritius. Applying the same principles to Mr Haworth, HMRC issued him with a follower notice which he challenged by seeking a judicial review on the grounds that Smallwood was not relevant to his arrangements.

His challenge was dismissed but he was given leave to appeal. The Court of Appeal ruled in his favour on the basis that HMRC had not satisfied all the conditions for issuing Mr Haworth with a follower notice.

Supreme Court finds for taxpayer

The Supreme Court had to decide whether or not HMRC had met the conditions under the Finance Act 2014 for issuing Mr Haworth with accelerated payment and follower notices. HMRC's argument rested on their opinion that the reasoning applied in the Smallwood case also applied to Mr Haworth's, maintaining that the same methodology deployed by Smallwood to avoid paying CGT was also used by Mr Haworth.

However, when the Court scrutinised HMRC's conclusion regarding the correct application of the Smallwood case, it noted that HMRC had only considered it 'likely' that the Smallwood ruling applied. The use of the word 'likely' meant the Court was not convinced that the condition relating to a relevant judicial ruling had been satisfied; the use of the word 'would' in section 205 (3) b of the FA 2014 makes it clear that there must be no doubt that the principles set out in a judicial ruling are 'relevant to the chose arrangements'.

The judgment emphasised that the severity of the penalty imposed on the taxpayer if HMRC's argument prevailed, was such that it was imperative that there is 'no scope for a reasonable person to disagree that the earlier ruling denies the taxpayer the advantage'. The Court also found that HMRC had misdirected itself by overstating the importance of the seven 'pointers' highlighted by the judge in Smallwood as features of Mr Haworth case. Finally, despite the Court not agreeing with two further issues raised by Mr Haworth, namely that the factual findings in a judgment do not form part of the reasoning given in a ruling, and that the serving of the follower notice was invalid, the Court dismissed HMRC's appeal.

Follower notice threshold raised

The judgment was at pains to emphasise the considerable financial risk run by a taxpayer who challenges HMRC's opinion of their tax arrangements, acknowledging that the legislation puts the taxpayer at significant disadvantage.

The fact that the case largely turned on the interpretation of the word 'would' demonstrates that the Court expects HMRC to reach a much higher threshold of proof when arriving at an opinion of whether or not a tax advantage should be denied.

Although the outcome of this case will cheer taxpayers seeking a tax advantage, it must be noted that judge commented that Mr Haworth's case was fact-specific and would be unlikely to help taxpayers who had entered a mass marketed tax avoidance scheme.

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