## It doesn't necessarily 'follow'!

*Mark McLaughlin looks at an important Supreme Court decision that should lessen the occasions on which HMRC issue follower notices to taxpayers*

Follower notices have become an important weapon in HMRC's armoury since the relevant legislation was introduced in FA 2014, with the government's intended aim of "…[changing] the economics of entering into tax avoidance schemes, and to change the behaviours of people and promoters in relation to tax avoidance."

In broad terms, HMRC can give a follower notice to a person who has used an avoidance scheme that has been shown in another person's litigation to be ineffective. The taxpayer faces a penalty of up to 30% of the tax and/or National Insurance contributions (NICs) in question if they do not amend their return or settle their dispute (plus an additional 20% broadly if the taxpayer or representative is found to have 'acted unreasonably' in bringing an appeal to the tribunal) (FA 2014, ss 208-208A).

However, if a follower notice is issued, it is important to check the notice for errors, and to ensure it complies with statutory requirements.

**Has HMRC jumped the hurdles?**

Four conditions (A to D in the legislation) must be satisfied before a follower notice can be issued. These are broadly as follows (see FA 2014, s 204):

A. A tax enquiry is in progress into a return or claim, or there is an open appeal, in relation to the relevant tax.
B. The return, claim or appeal asserts a particular tax advantage from the chosen arrangements.
C. HMRC's opinion is that a 'judicial ruling' (i.e., by a court or tribunal) is relevant to the chosen arrangements.
D. No previous follower notice has been given to the same person, by reference to the same tax advantage, tax arrangements, judicial ruling and tax period (unless the previous ruling has been withdrawn).

Before a follower notice is issued in relation to a relevant judicial decision, a senior HMRC panel will consider whether it is appropriate to apply that ruling in the follower cases. However, the follower notice must be issued within a twelve-month statutory timeframe (see s 204(6)).

A judicial ruling is 'relevant' if 'the principles laid down, or reasoning given, in the ruling would, if applied to the chosen arrangements, deny the advantage or part of [it]', and it is a final ruling (FA 2014, s 205(3)(b)). A 'final ruling' is defined as including a Supreme Court ruling, or a ruling of any other court or tribunal if no appeal may be made against it or an appeal may be made with permission but the time limit has expired without an application being made or permission has been refused.

Difficulties often arise for tax practitioners in attempting to interpret tax legislation, particularly where it lacks clarity so is open to different interpretations. The 'relevant' judicial ruling test in section 205(3)(b) is one such example.

**When interpretations differ**

In R (on the application of Haworth) v HMRC [2021] UKSC 25, a trust established by the taxpayer for himself and his family held shares in a company. To avoid capital gains tax (CGT) on a disposal of those shares, a scheme was devised whereby the existing Jersey trustees resigned in favour of trustees resident in Mauritius. The Mauritian trustees became shareholders in the new company. All the shares that the trust

held in the new company were sold. Subsequently, UK trustees replaced the Mauritian trustees. The effectiveness of the arrangements depended on a combination of the legislation in TCGA 1992 and the operation of the UK/Mauritius double taxation convention (DTC), and particularly on the 'place of effective management' (POEM) of the trust being in Mauritius upon disposal of the shares.

In the taxpayer's self-assessment return for the tax year 2000/01, he disclosed having entered into arrangements whereby he asserted to have avoided any charge to tax on a substantial capital gain arising from the disposal of shares by a trust of which he was the settlor. HMRC opened an enquiry into the return. In 2016, HMRC issued him with a follower notice on the basis HMRC considered that the taxpayer's arrangements were materially the same as those considered by the Court of Appeal in Smallwood v RCC [2010] EWCA Civ 778. In particular, HMRC said Smallwood established that, on the true construction of the DTC, the POEM of the taxpayer's trust was in the UK at the time of the disposal and that, as a consequence, he was not relieved of liability from CGT as he claimed.

The taxpayer applied for judicial review of the follower notice. The High Court dismissed his application. However, his appeal was allowed by the Court of Appeal, who unanimously quashed the follower notice on the basis that HMRC overstated the conclusions in Smallwood and so misdirected themselves. In addition, the court considered that to give a follower notice, HMRC's opinion must be that the principles or reasoning in the ruling in question would deny the relevant advantage, not merely that they would be likely to do so. This involved a further misdirection. The taxpayer's appeal was allowed. HMRC appealed.

**'Would' or 'might'?**

One of the principal issues for the Supreme Court (SC) was whether HMRC formed the opinion required by FA 2014, s 205(3)(b) that "the principles laid down or reasoning given in [Smallwood] would, if applied to [the taxpayer's] arrangements, deny the asserted advantage". The SC's answer was "no".

The issue turned on what was meant by the word 'would' in section 205(3)(b), which indicated that HMRC must form the opinion that there was "no scope for a reasonable person to disagree that the earlier ruling denies the taxpayer the advantage". The statutory wording gave full weight to the word 'would' rather than (for example) 'might'. In the present case, HMRC accepted that its evidence showed no more than that HMRC concluded it was 'likely' that the application of Smallwood would deny the taxpayer his tax advantage. That was not sufficient for the purposes of section 205(3)(b).

The SC went on to consider (among other things) whether HMRC misdirected themselves in their analysis of Smallwood and whether this made a difference to HMRC's decision to issue the follower notice. The SC answered this issue "yes". HMRC proceeded on the basis that if seven specific indicators which HMRC considered had been highlighted in Smallwood were present in a case, the place of effective management (POEM) of the trust would inevitably be in the UK. However, this overstated the conclusion of the court in Smallwood, which did not consider the seven indicators to be necessary and sufficient to establish that, in any other case, the POEM of a trust was in the UK. The SC unanimously upheld the Court of Appeal's decision to quash HMRC's follower notice.

**HMRC guidance**

Interestingly, HMRC's own guidance on follower notices (tinyurl.com/HMRC-F-AP-N) includes its interpretation of 'relevant ruling': "The legislation does not mean that a follower notice can, for example, be issued in any case involving a 'trading or non-trading' argument, solely because there has been a judicial ruling on that point. The reasoning and principles behind that ruling must be scrutinised to consider whether or not they can be applied to the potential 'follower cases'."

HMRC's guidance goes on to state: "This will include considering carefully the context of the ruling and whether it is reasonable to apply the same reasoning to the context of the follower case(s). It is not about extracting a wide general principle from a case and then applying that to other cases where the context and facts are substantially different."

**Conclusion**

The SC's decision in Howarth is clearly good news for taxpayers. It confines HMRC's scope to issue follower notices as its powers had previously been applied and should (hopefully) make HMRC more selective when considering whether it is reasonable to apply the reasoning of earlier rulings to subsequent cases.

Or will it? Establishing whether there is scope for a 'reasonable person' to disagree that a judicial ruling determines the taxpayer's case is a subjective exercise, which requires a threshold to be crossed. It is not difficult to imagine HMRC's threshold of 'reasonable person' differing from the taxpayer's threshold. Nor is it difficult to imagine (for the author, at least) further litigation on follower notices between HMRC and taxpayers in the future.

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