A request too far

Management of taxes



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Keith Gordon considers a recent judicial review claim which examines the geographical reach of HMRC’s information powers

Key Points

What is the issue?

This case focused solely on the question as to whether or not the First-tier and HMRC were entitled to approve and issue a Schedule 36 notice to an individual resident overseas.

What does it mean to me?

Since Schedule 36 imposes no territorial restrictions, HMRC presumably considered it had worldwide application. As Mr Justice Charles has demonstrated, this assumption might be incorrect.

What can I take away?

Given the potential appeal, any action taken now will be of a provisional nature only. Nevertheless, any overseas taxpayer with a Schedule 36 notice should carefully consider this decision as that would suggest that the notice was unlawfully issued.

It is a fact of life that exposure to UK tax is not limited to UK residents. As a general rule and in the interests of simplicity one can say that non-residents are subject to UK tax in relation to UK-based sources of income. Leaving aside any philosophical considerations, one practical reason for restricting the UK tax net to UK sources is that an asset in the UK provides a basis for HMRC to enforce any unpaid tax. It should of course be noted that this is not the only possible solution: for example, the United States has hitherto not hesitated to levy US taxes on its non-resident citizens on their worldwide income.

Given their potential worldwide ‘customer base’, it is unsurprising that HMRC will want to ensure that as many as possible of their powers will be available to them. This article considers the extent to which HMRC are entitled to issue overseas taxpayers with information notices under the Finance Act 2008, Schedule 36, which was the subject of a recent judicial review case, *R (on the application of Jimenez) v First-tier Tribunal (Tax Chamber) and HM Revenue & Customs* [2017] EWHC 2585 (Admin).

Facts of the case

HMRC wanted information from Mr Jimenez who (for the purposes of the case) was assumed to be resident in Dubai at the time. Although (subject to the issues raised in this case) HMRC might have issued a notice under paragraph 1 of Schedule 36, against which Mr Jimenez would have had the right of appeal, HMRC took the alternative approach available to them under the statute. That alternative approach was to obtain the First-tier’s prior approval of a notice, meaning that Mr Jimenez had

no right of appeal, his only legal remedy being by way of judicial review following the issue of the notice.

As is usual in such cases, Mr Jimenez was given advance notice of HMRC's proposed application and an opportunity to make representations to HMRC. Under the statutory scheme, this is obligatory (subject to HMRC's ability to persuade the Tribunal to dispense with the requirement). If representations are made, it is then incumbent on HMRC to provide the Tribunal with a summary of them.

HMRC's application was duly heard and the Schedule 36 notice was approved by the Tribunal.

Since the introduction of the Finance Act 2008 rules (and, particularly, following an amendment made by the Finance Act 2009), several taxpayers in such situations have also sought to attend the Tribunal hearing at which HMRC make their formal application and/or to make submissions direct to the Tribunal. The First-tier has routinely rejected such efforts, holding that to do so would encroach upon HMRC's unfettered right to address the Tribunal in private. Indeed, the Tribunal has ruled that it has no discretion to permit the taxpayer's participation in the proceedings. Mr Jimenez made a similar application which was duly rejected by the Tribunal. That rejection was subsequently the subject of his judicial review claim but permission was refused and the matter was not pursued any further.

Consequently, the present case focused solely on the question as to whether or not the First-tier and HMRC were entitled to approve and issue a Schedule 36 notice to an individual resident overseas.

The High Court's decision

The case came before Mr Justice Charles. As Schedule 36 is silent on territorial limits, he noted that the House of Lords' decision in *Clark (HM Inspector of Taxes) v Oceanic Contractors Inc* [1983] 2 AC 130 was relevant.

In short, *Oceanic* confirmed the principle that (as a general rule) Parliamentary statutes should be construed as having their effect only on British subjects or others present in the UK. This is, of course, subject to the statute clearly stating (or implying) otherwise. Therefore, as was acknowledged in *Oceanic* itself, the UK tax code has a wider territorial scope, although it might prove more difficult for the UK to enforce tax debts overseas (following the principles explained in *Government of*

India v Taylor [1955] AC 492) subject, of course, to any mutual assistance arrangements that might be in place).

The Judge also cited the case of *Perry v SOCA* [2013] 1 AC 182, which concerned information notices under the Proceeds of Crime Act. There, the Court remarked that there is nothing to stop an information request being sent anywhere in the world. However, it is very different if the request contains an obligation which is backed up by penal sanction. (Thus, in the context of Schedule 36, there is nothing to stop HMRC sending out informal requests anywhere in the world. However, as this case discusses, formal Schedule 36 notices (which carry a penalty if there is not complete compliance) are different.)

The Judge accepted much of what the Court of Appeal said in *R (oao Derrin Brothers Properties Ltd) v FTT* [2016] EWCA Civ 15 about the need for the Schedule 36 powers and for them 'to provide credible and effective system of checking and investigation'. However, he continued, *Derrin* does not tell the whole story because that case was not concerned with territorial limits.

In particular, the Judge noted that HMRC were clearly given powers to issue information requests on behalf of overseas tax authorities, which suggests that where HMRC are investigating a person overseas, they should make a corresponding request of an overseas tax authority for the latter to use its own information powers (assuming that the relevant assistance agreement has been reached). Furthermore, the Judge recognised that any taxpayer who leaves the UK in order to escape HMRC's investigatory powers can still be the focus of third-party notices issued to UK-based organisations with whom the taxpayer had transacted, irrespective of the country to which the taxpayer has moved.

The Judge also considered the other powers within Schedule 36, on the basis that the entire code has to be read in context. Those powers include inspection powers and the Judge thought that it would 'raise eyebrows' if Parliament intended such inspections to be carried out overseas.

Consequently, even though Mr Jimenez was a UK citizen, the Judge considered that the statute should be interpreted in accordance with the usual presumption, being not to impose a penal sanction on a person outside the jurisdiction, as that would offend against the sovereignty of another state. He therefore ruled that HMRC should not have issued the notice to Mr Jimenez and he duly quashed it.

Commentary

One of the practical difficulties in dealing with HMRC these days is their firm belief that they are always right and can do whatever they want. I usually put this down to poor training. If a junior officer is told that the law means X, the officer will not unreasonably proceed on the assumption that that is right and will repeat the assertion to taxpayers and advisers. The fact that most taxpayers and many advisers will not know differently (or will not wish to embark upon costly, time-consuming and emotionally-draining proceedings to prove that the officer is wrong) will only reinforce the officer's view of the law. Furthermore, HMRC are not afraid to ask Parliament for (and usually get) increased powers just in case their existing arsenal is not sufficient.

It is therefore not surprising that HMRC would have assumed that Schedule 36 entitles them to ask anyone for information. After all, since Schedule 36 imposes no territorial restrictions, HMRC presumably considered it had worldwide application. As Mr Justice Charles has demonstrated, this assumption might be incorrect. Although this will prove a welcome decision for Mr Jimenez, it is perhaps not surprising that HMRC have sought permission to appeal against the Judge's decision. The outcome of that process will become clearer in the following months.

Also of interest is the fact that the Judge took the trouble to add some comments of his own regarding the current practice involving HMRC's applications for the Tribunal's approval being routinely heard behind closed doors. I have long doubted the correctness of the Tribunal's current approach, both on the basis of the wording of the underlying statutory code and also the more nebulous concept of fairness. One difficulty with the current approach is that there is no public scrutiny of the process or even any opportunity for the Tribunal to monitor closely how HMRC use these powers. For example, suppose the Tribunal decides that HMRC have not done enough to justify the Tribunal's approval of a notice in a particular case, what (in practice) is going to stop the same officer repeating the application before a different Judge on a different day? Is this me just being paranoid or is that in fact normal practice? The fact that one just does not know is itself a cause for concern.

The Judge recognised that his comments were not the subject of legal argument before him (as permission had been refused) and also that they seemed to go against the binding decision of the Court of Appeal in *Derrin*. Nevertheless, he felt sufficiently troubled to comment that:

- especially when a public hearing is sought by the taxpayer, it is at least arguable that HMRC's concerns as to taxpayer confidentiality are not sufficient to justify a private hearing;
- the fact that representations may usually be made from the taxpayer undermines any argument that the taxpayer's attendance at a hearing would risk letting the 'cat out of the bag';
- the case law on Tribunal procedure more widely (where there are confidential matters to be raised) has been updated since the seminal tax cases concerning the legislation that preceded the Schedule 36 provisions; and
- shutting out the taxpayer altogether is arguably at odds with the Tribunal's own statutory duty to act fairly.

It is not clear whether HMRC or the Tribunal will unilaterally or together seek to reconsider their approach to such cases in the light of the Judge's comments or whether they will consider themselves bound by their current procedures as endorsed in *Derrin*. If the latter, it is to be hoped that a dissatisfied taxpayer (emboldened by the Judge's concerns) would pursue a judicial review claim and that permission would eventually be given.

What to do next

Given the potential appeal, any action taken now will be of a provisional nature only. Nevertheless, any overseas taxpayer with a Schedule 36 notice (whether issued with or without the Tribunal's prior consent) should carefully consider the *Jimenez* decision as that would suggest that the notice was unlawfully issued. Arguably, the unlawfulness of the notice could itself be a basis for an appeal against a subsequent penalty for non-compliance although the precise relationship between unlawful notices and subsequent enforcement action is the subject of considerable litigation at the moment (particularly in the context of Accelerated Payment Notices, but also in the context of Schedule 36 itself – see, for example, *PML Accounting Ltd v HMRC* [2015] UKFTT 440 (TC) (as discussed in my December 2015 article, which then experienced an interesting twist in 2017). A safer approach would be to challenge the Schedule 36 notice itself, either by appeal (if that option is available) or by way of judicial review. To keep costs down, it might be possible for such proceedings to be stayed pending the outcome of the *Jimenez* proceedings. But I would strongly discourage any taxpayer from missing the strict JR and appeal time limits: a claim or appeal should ordinarily be commenced within the strict statutory time constraints

and then subject to an application for a stay.

Similarly, irrespective of the location of the taxpayer, one should note the concerns expressed by Mr Justice Charles regarding the process by which the Tribunal considers prospective Schedule 36 notices. As commented above, this process is worthy of a further examination by the Courts. Consequently a taxpayer wanting to attend such a hearing should not necessarily be content with the response that open hearings are not permissible.