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Jon Claypole and Jonathan Levy consider the recent decision in *Haworth v HMRC*

Key Points

What is the issue?

In what circumstances will the ‘principles or reasoning ‘ in a relevant judicial ruling apply to the taxpayer’s chosen arrangements, such as to enable HMRC to issue a Follower Notice to deny him/her the claimed tax advantage?

What does it mean to me?

The FN regime differs to the APN regime because it requires the client to close the HMRC enquiry or risk a 50% penalty for the right to challenge the substantive point, so the issues carry very substantial financial implications.

What can I take away?

The effect of the *Smallwood* decision is that Hughes LJ's summary of those facts can be applied as the 'principles or reasoning' for HMRC to issue FNs, even though the facts and circumstances relevant to the POEM of each trust may materially differ. HMRC also now have the 'green light' to introduce a streamlined process when considering whether to issue a FN, which means that the WFGG will be relying on the opinion of any member of an HMRC team, rather than subjecting the issue of FNs to the high level scrutiny promised by Ministers when the FN legislation was first introduced.

As many readers will be aware, a Follower Notice (FN) can be given where the 'principles or reasoning' in a relevant judicial ruling would, if applied to the taxpayer's chosen arrangements, deny him/her the claimed tax advantage, and an accelerated payment notice (APN) can require him/her to pay the tax up-front. The FN regime differs to the APN regime because it requires the client to close the HMRC enquiry or risk a 50% penalty for the right to challenge the substantive point.

This important legislation has now been the subject of a recent judicial ruling, *R (on the application of Geoffrey Richard Haworth) v HMRC [2018] EWHC 1271* (23 May 2018).

The background

The claimant filed an action for judicial review against HMRC, challenging their decision in 2016 to issue an APN and FN in relation to gains arising to the trustees of a settlement of which he was the settlor. The claimant argued that he was not chargeable in respect of the gains made because they were exempted from the charge to UK capital gains tax by virtue of the UK/Mauritius double tax treaty ('the treaty') at a time when the trustees were resident in Mauritius, having replaced trustees in Jersey. If, applying the 'tie-breaker' provisions under the treaty, the place

of effective management (‘POEM’) of the trust was in Mauritius, not the UK, the gain would be exempt from UK CGT. There was no Mauritian tax on the gain. HMRC refers to the arrangement as the ‘Round the World’ tax avoidance scheme.

The facts

In 2000, the Trust had a 30% shareholding in a company (‘TradeCo 1’), with 20% owned absolutely by the Claimant. Initially, the trustees of the Trust were resident in Jersey.
In connection with a proposed flotation on the London Stock Exchange, the shares in TradeCo1 were to be acquired by a new company (‘TopCo’) in return for shares in NewCo. NewCo would also acquire another company, TradeCo2, in return for shares. As part of the flotation, NewCo would issue further shares and some of the existing shares would be sold by means of a placing of those shares with institutional investors. It was far from certain that the flotation would proceed due to volatile market conditions of the industry in which the entity operated.

Advice was received that, in the event that the flotation proceeded, any gains realised on the disposal of shares might be sheltered if the existing Jersey Trustees resigned in favour of trustees resident in Mauritius. This was because there was no capital gains tax in Mauritius and gains arising to the Trust, if resident in Mauritius for Treaty purposes, would not be chargeable in the UK by reason of the Treaty.

Following such advice, the Jersey trustees decided to retire (on 26 June 2000) in favour of independent Mauritian trustees. The Mauritian Trustees agreed to the merger of the two TradeCos by agreeing to a share-for-share exchange, thus owning shares in the entity that was proposed to be floated. The Mauritian Trustees further decided to sell some of their shares in the course of the flotation and, on 3 August 2000, disposed of the majority of the Trust’s shareholding. To meet investor demand for NewCo shares, the Trustees also agreed to dispose of further shares by way of a ‘greenshoe’ option.

On 24 October 2000, the Mauritian Trustees decided to resign in favour of UK-resident trustees.

The Smallwood decision

In *Smallwood v Revenue and Customs Commissioners [2010] EWCA Civ 778* the issue was where the POEM of a trust would be found. On the particular facts found, the Special Commissioners found this to be in the UK. In the Court of Appeal, Patten LJ ruled that, since the directors of the corporate trustee remained in place and exercised their powers as directors to effect the sale, their role had not been usurped and *Wood v Holden [2006] EWCA Civ 26* would therefore apply. The Special Commissioners could not therefore properly have concluded that the POEM of the trustees at the relevant time lay in the UK rather than in Mauritius.

Hughes LJ (Ward LJ concurring) agreed with Patten LJ on the *Wood v Holden* point, but held that the Special Commissioners' conclusion on the issue of POEM was one of fact and applying *Edwards v Bairstow* [1956] AC 12 principles, decided that on the facts found by the Special Commissioners their conclusion did not indicate any error of law. At paragraph 70, Hughes LJ gave a short summary of the facts which made their conclusion legally permissible.

Advice from HMRC Solicitor's Office

Using this summary, HMRC's Solicitor's Office gave advice that in another case the tribunal was likely to reach a similar result having regard to seven factors that became known in various documents as the 'Smallwood pointers', 'Smallwood hallmarks', or 'Smallwood criteria'. One factor for example was that it was integral to the scheme that the trust should be exported to the overseas territory [i.e. Mauritius] for a brief temporary period only.

The Claimant's arguments: Ground 1

The claimant contended that HMRC's issue of a follower notice in his case was wrong in law, since there were no *principles or reasoning* of general application arising from Smallwood, as required by section 205(3) of the 2014 Act, which would deny him a tax advantage.

Cranston J did not agree: 'Hughes LJ's judgment contains reasoning applicable in other cases…and there was what he termed "a scheme of management" of the trust "which went above and beyond the day to day management exercised by the trustees for the time being, and the control of it was located in the UK".'

But, in fact, this part of Hughes LJ's summary was not part of the Smallwood criteria used by HMRC.

The Claimant's arguments: Ground 2

The claimant submitted that having regard to the language in section 205(3)(b), the consultation documents, and various Ministerial statements (which indicated that FNs were to dissuade taxpayers from pursuing appeals which an earlier decision had indicated would be hopeless), the principles or reasoning in Smallwood were sufficiently determinative so that one could say that they 'would … deny the asserted advantage' and HMRC had not formed the view that the Claimant's case was hopeless. Cranston J again did not agree: 'I simply note that the statutory language is clear … Whatever might have been said during the process of formulating and enacting the follower notice regime, there can be no resort to this under *Pepper (Inspector of Taxes) v Hart* [1993] AC 593 when the legislation is unambiguous.'

The Claimant's arguments: Ground 3

The claimant contended that the Follower Notice did not give the explanation required by section 206 of the Finance Act 2014 as to why Smallwood determined its case. Cranston J said: 'In my view the follower notice itself provided, albeit succinctly, an explanation of why HMRC considered that Smallwood was the relevant judicial ruling and that corresponding reasoning applied to the claimant's case.'

The Claimant's arguments: Ground 3A

a) Improper delegation

The claimant submitted that the power to issue follower notices is vested in HMRC, which under the 2005 Act is defined to mean the Commissioners and the officers of Revenue & Customs. The Claimant contended that the power had been conferred on the department consisting of the Commissioners and officers, and not each and every officer of Revenue & Customs. The Commissioners duly delegated the function to a governance panel called the WFGG under section 14 of the 2005 Act, but under a 'streamlined' process it delegated the task to the compliance team, which in turn appears to have delegated it to a single HMRC Officer, a Mr Smith. That was, it was

claimed, in breach of the principle that a delegate cannot normally sub-delegate his authority. Again, the Court disagreed: ‘To my mind the legislation did not forbid what HMRC established for the administration of follower notices….Section 4(1) of the 2005 Act provides that references to HMRC are to the Commissioners and the officers of Revenue and Customs together…Neither the guidance nor the assurances suggested that the high level committee was not to delegate functions to officers within HMRC. That would have been unrealistic…’

b) Insufficient evidence

The claimant further contended that there was no evidence that anyone in HMRC completed a review of the claimant’s case as to where the POEM of the trust was located and whether or not a follower notice could be issued. The ‘Smallwood pointers’ pertaining to the Claimant were set out on a spreadsheet, but it appeared that the reviewing Officer, Mr Smith, had made only 9 entries, and had ignored over 200 pages containing important and relevant documents.

Cranston J said: ‘As I noted earlier, it is most unfortunate that there is no direct record of the conclusion of the review in the claimant’s case. But in light of Ms Tilling’s (the Lead Compliance Officer on the review team) unchallenged evidence, it is impossible for the claimant to contend that the review was incomplete.’

c) Required independent review

Finally, Cranston J dismissed the argument that it could not be demonstrated that the designated officer had reached the required independent view when issuing the accelerated payment notice. This was because the designated officer saw his role as calculating the understated tax, rather than considering the efficacy of the arrangement.

The Court held, however, that the designated officer was entitled to rely on the previous decision that a follower notice should be issued.

Conclusions

The Claimant’s difficulties stem from the Special Commissioner’s decision in *Smallwood* because the Court of Appeal refused to disturb their judgment on the facts, even if their Lordships might have reached a different conclusion. The effect of

this judgement is that Hughes LJ's summary of those facts can be applied as the *principles or reasoning* for HMRC to issue FNs, even though the facts and circumstances relevant to the POEM of each trust may materially differ. HMRC also now have the 'green light' to introduce a streamlined process when considering whether to issue a FN, which means that the WFGG will be relying on the opinion of any member of an HMRC team, rather than subjecting the issue of FNs to the high level scrutiny promised by Ministers when the FN legislation was first introduced.

The Claimant has applied for permission to appeal this case to the Court of Appeal. If granted, all these arguments will be tested once more and it remains to be seen whether a different view will be taken. The impact of the Claimant succeeding will put into question the procedure adopted by HMRC when issuing follower notices to other participants of the 'Round the World' planning.

Levy and Levy acted as solicitors to the Claimant. Mazars are acting as tax advisers to the claimant.