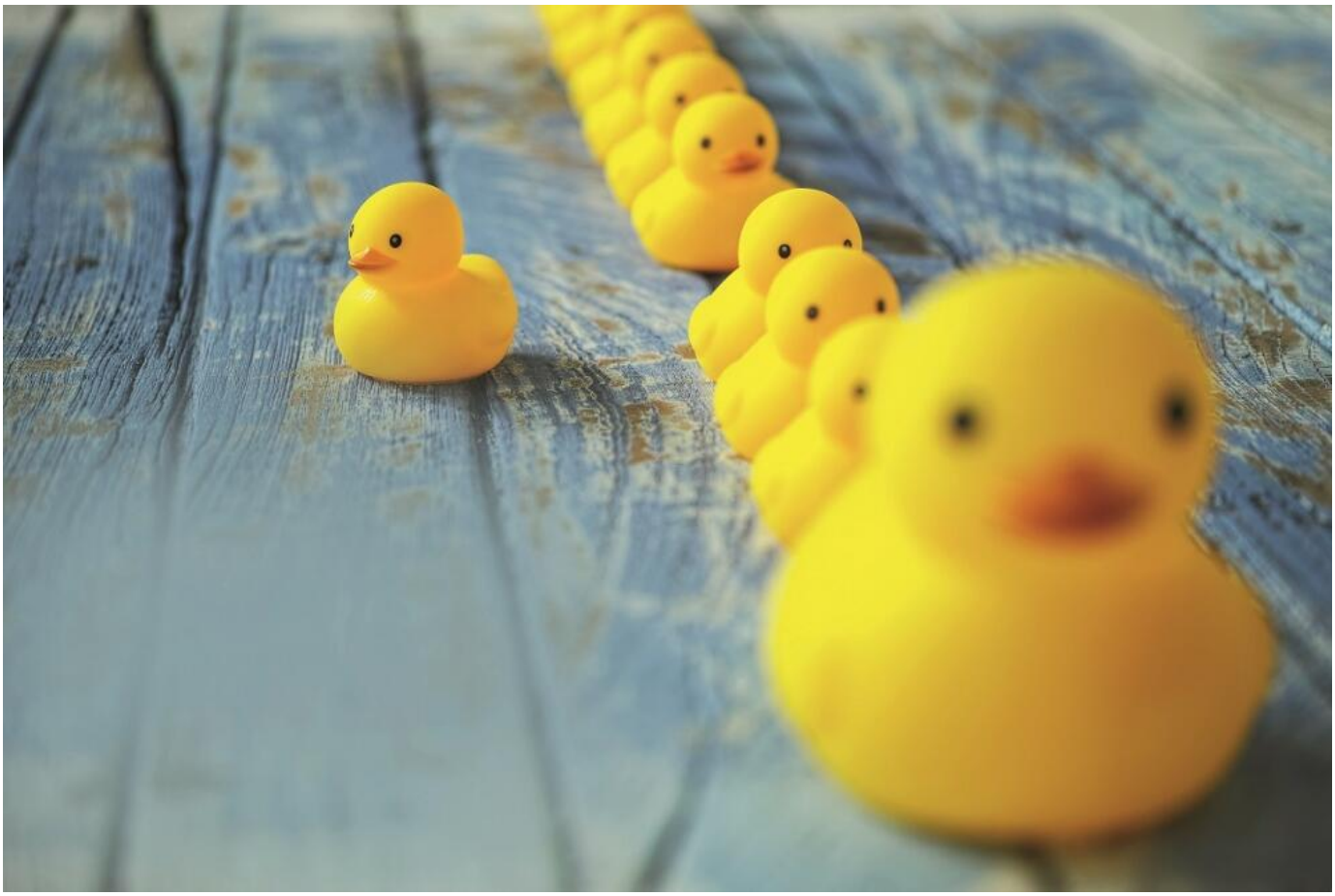
Following the leader

Management of taxes



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Hilesh Chavda and *Elyse Waller* provide guidance on dealing with Follower Notice

Key Points

What is the issue?

HMRC have been given significant powers to assist them in resolving tax disputes in the form of Follower Notices and Accelerated Payment Notices (APN). Complying with a Follower Notice irrevocably determines the taxpayer's position which might

not be what the taxpayer intends to do at such an early stage. Further, the APN could cause significant financial hardship. This is certainly the case for many Eclipse members who are currently receiving Follower Notices and APNs.

What does it mean for me?

There could be scope to challenge the notices on the basis that the taxpayer does not agree with HMRC's analysis of how the Follower Notice and APN regime works. Therefore, taxpayers who receive notices (including Eclipse members) must decide whether they are going to pay sums demanded by the APN and/or comply with the Follower Notice or challenge the notices with regard to the longer term aim of the impact on ultimate settlement.

What can I take away?

Careful consideration of the basis of HMRC issuing a Follower Notice and APN is required as there could be scope to challenge the notices if all the requirements to issue them have not been satisfied. The Follower Notice and APN regimes have specific rules regarding how they can be challenged and these must be followed carefully. There is a good argument that the Eclipse 35 decision does not conclusively preclude application of the relief sought. Therefore, a number of Eclipse members are challenging the notices by way of representations and Judicial Review.

On 13 April 2016 the Court of Appeal's decision that Eclipse Film Partners No. 35 LLP ('Eclipse 35') was not trading, as found by the First-Tier Tribunal, became final when the Supreme Court refused to grant permission to the partnership to appeal against the decision. In the time that has passed since then, HMRC has issued Follower Notices and APNs to individual members of the Eclipse Film Partners No. 1-39 LLP ('the Eclipse LLPs'). They deny members the tax advantage claimed under the arrangements, being sideways interest relief, and require upfront payment of the tax advantage amount.

Members are now in the process of deciding whether to comply with the Follower Notices and pay the APN amount or if there is merit in challenging the notices. Set out below is an overview of the Follower Notice and APN regimes. Given that HMRC are in the process of sending out the Eclipse notices, Eclipse has been used as an example to illustrate the issues to be considered and how taxpayers can challenge

the notices.

Follower Notices

A Follower Notice is a request by HMRC to a taxpayer, who has used a tax avoidance scheme that has been determined by another taxpayer's litigation to be ineffective, to amend their tax return to permanently remove the tax advantage claimed.

The regime was designed to incentivise taxpayers to accept decided cases and pay any underpaid tax and NICs to HMRC thereby accelerating and increasing the open enquiries being resolved.

The conditions which must be met in order for a Follower Notice to be issued are:

1. HMRC is enquiring into the taxpayer's return or claim or the taxpayer has made an appeal that has not yet been determined;
2. the taxpayer made the return, claim or appeal on the basis that a particular tax advantage arises from the tax arrangement;
3. HMRC is of the opinion that there is a final judicial ruling that is relevant to the taxpayer's tax arrangement;
4. HMRC has not previously issued a Follower Notice to the taxpayer for the same tax arrangement, tax advantage, ruling and period; and
5. the time limit for issuing a notice has not expired, being the later of 12 months from the date of the judicial ruling becoming final or 12 months from the day that HMRC received the taxpayer's return, claim or appeal.

A tax arrangement is an arrangement (including any agreement, understanding, scheme or transaction) where the main purpose is to obtain a tax advantage, which includes avoidance, repayment or deferral of tax.

A ruling is final if it is a ruling of the Supreme Court or another Court and all rights to appeal have been exhausted. A ruling is relevant if, when applied to the taxpayer's tax arrangements, the ruling would deny the tax advantage sought by the taxpayer.

Upon receipt of a Follower Notice, a taxpayer has three options:

Comply with the notice

Taxpayers have 90 days to comply with a Follower Notice by taking the corrective action requested by the notice. For Eclipse members this is to amend their Self Assessment tax return for the relevant year to remove the tax benefit claimed. This is an irrevocable decision by taxpayers to forfeit the tax advantage.

Challenge the notice

There is no right to appeal a Follower Notice. However, representations can be made to HMRC challenging its validity on the basis that one of the conditions have not been met. If HMRC does not accept the representations made and the Follower Notice is upheld, an application for Judicial Review may be brought in the Administrative Court in respect of the decision to not accept the representation(s).

Do nothing

The tax advantage will not have been forfeited, however, HMRC can impose penalties.

HMRC can impose penalties of 10% to 50% of the value of the denied advantage. The amount of the penalty will depend on the level of cooperation provided by the taxpayer prior to the penalty being issued.

Accelerated Payment Notices

An APN is a demand from HMRC for payment on account for an amount of tax which HMRC considers it is owed before the liability to tax has been determined. For members of Eclipse, the APN amount is the tax benefit claimed.

An APN can only be issued to taxpayers who have used a tax avoidance scheme and the following conditions have been met:

6. HMRC is enquiring into the taxpayer’s return or claim or the taxpayer has made an appeal that has not yet been determined;
7. the taxpayer made the return, claim or appeal on the basis that a particular tax advantage arises from the tax arrangement; and
8. the taxpayer has been given a Follower Notice, used a DOTAS notifiable arrangement or is subject to a GAAR counteraction notice.

The Eclipse members are receiving APNs as a result of the Follower Notices which are being issued.

Upon receipt of an APN, a taxpayer has three options:

Comply with the notice

Taxpayers have 90 days to pay the APN amount in full. This can often amount to life changing amounts which the taxpayer may struggle to pay in such a short period.

Challenge the notice

As with a Follower Notice, there is no right of appeal against an APN. However, representations can be made to HMRC challenging the validity of the APN, on the basis that one of the above conditions has not been met. A claim for Judicial Review may also be made if required.

As Eclipse members have received their APNs on the basis that a valid Follower Notice has been issued, should it be determined that the Follower Notice is invalid, the APN will also be invalid.

Where representations have been made in respect of the APN and the associated Follower Notice, payment of the APN is effectively deferred as payment will not be due until 30 days after a decision is issued by HMRC on representations.

The APN amount can be deferred further where taxpayers become claimants in a Judicial Review challenging the validity of an APN and they successfully apply for an order for interim relief to defer payment for the duration of the Judicial Review. In order to benefit from an order for interim relief the taxpayer needs to provide evidence of hardship to satisfy the court that they cannot pay the APN amount immediately.

If a taxpayer does not make payment of the APN amount in full (or enter into a time to pay arrangement with HMRC) before the due date, being 90 days after the notice was issued or 30 days after a decision on representations is made by HMRC, a penalty of 5% of the APN amount will be issued the day after payment was due. A further 5% penalty will be issued on the 5 month and 11 month anniversary of the due date for payment if the amount remains outstanding.

Eclipse Follower Notice and APN Challenge

A number of Eclipse members are challenging the notices issued by way of representations and, if required, Judicial Review. HMRC's assumption is that the final determination of the Eclipse 35 appeal means that interest relief is not available to Eclipse investors.

However, the Eclipse 35 decision merely determined that Eclipse 35 is not carrying on a trade which does not necessarily lead to the conclusion that interest relief is not available as interest relief may be available on an alternative basis. In addition, Eclipse 35 is the only partnership that has been found not to be trading and it does not necessarily follow that all Eclipse partnerships are not trading. Further taxpayer specific arguments regarding whether the other conditions for issuing a Follower Notice have been met can be made. These include whether an enquiry has been validly opened in respect of the year that HMRC is issuing the Follower Notice or whether there is an open appeal into the member's tax return in respect of the tax advantage claimed.

If Eclipse members do not challenge the notices and comply, they will be irrevocably forfeiting their claim to interest relief and required to pay significant amounts before their particular tax position in respect of this arrangement has been finally determined.

Conclusion

The Follower Notice and APN regimes are examples of the increased powers granted to HMRC to seek to streamline the process for resolving tax disputes. However, it is important that HMRC use these powers within the confines of the conditions set out in the legislation. By issuing Follower Notices and APNs to all Eclipse members, HMRC is arguably overstepping its powers. It will be up to the Courts to ensure that these significant powers are exercised within the defined boundaries.