

An attempt by HMRC to charge tax on a void transaction finds no support at the tribunal.

The recent case of *Russell Baker v HMRC* [2013] UKFTT 394 TC raises some interesting issues. On the face of it, everything seemed reasonably straightforward – but not for long.

Mr Baker received a payment of £120,000 from his company, which was intended to be a purchase by the company of its own shares. Unfortunately, quite a lot went wrong with the arrangements. The statutory conditions for a lawful purchase of a company's own shares were not satisfied; for example, there were insufficient distributable profits and it was generally in breach of some relevant parts of the Companies Act 1985. In addition, the shares had not been held for the necessary period for the desired tax treatment. It seemed clear that the transaction was void, but HMRC took the view that, even so, this £120,000 should be taxed as a distribution.

HMRC suggested that Mr Baker should be taxed on the basis of 'economic reality'; he had received the money from the company for his shares and 'the tax treatment must follow the economic reality' (sic). The fact that the payment could not lawfully be a dividend and that the statutory conditions for it to be treated as a dividend were not satisfied, did not seem to represent any kind of impediment.

Life is too short to permit an analysis of all the implications of such an approach, but a few obvious points arise. For example, there is not much point in having statutory rules if it does not matter whether you satisfy them or not. It might even be said that seeking to levy taxes on such a basis would be arbitrary taxation. That has been thought to be wrong for quite a long time – since the Bill of Rights 1689, for example.

If HMRC can argue that taxes can be levied on the basis of economic reality and without regard to the satisfaction of any statutory rules, could this be really helpful to the taxpayer? I don't think so. The acid test would be to look at this argument the other way round. Imagine the taxpayer had said to HMRC: 'I want this payment to be treated as a dividend (because that would be to my advantage) but, unfortunately, it is unlawful for it to be a dividend. I have not satisfied any of the statutory tax rules for this treatment; nor have I satisfied any of the Companies Act rules – but I would still like it treated as a dividend.' I expect HMRC would soon change its mind about this being a good argument – once it had stopped laughing.

I cannot help thinking that, if economic reality is a proper way of determining tax liabilities, HMRC might have had regard to this principle when considering the case of Mr Lobler (*Joost Lobler v HMRC* [2013] UKFTT 141 TC) who became liable to pay tax which exhausted his life savings just because he made a partial surrender of his life policy. He made no profit but still had to pay huge amounts of tax by reference to the specific legislation – wholly contrary to any kind of economic reality. The First-tier Tribunal said this was 'outrageously unfair', but HMRC pursued the point anyway.

It was a relief to find that the tribunal judges did not think much of the economic reality argument – nor did they think that a void transaction could be recategorised into anything else. It was void, it never happened, and any money received by Mr Baker needed to be returned to the company.



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