Protect & serve

Peter Vaines calls for greater security for taxpayers against negligence charges & a dose of common sense

IN BRIEF

- A new (and unwanted) dimension to taxpayers' difficulties.
- Why ehancement expenditure trumps purposive interpretat.ion.
- Discovery assessments and the need further refinement.

It is a reasonable proposition that a person should not be liable to a penalty when he has relied on professional advice. This was explained in *Mariner v HMRC* TC 3039 in which the tribunal said that the taxpayer could not be principally or vicariously liable for the negligence of her professional adviser unless the circumstances indicated that the matter was fraught with difficulty and doubt. It was contrary to the very notion of reasonable care that a person who perceives a need to take professional advice can be said to be negligent if she then relies on that advice—even if it turns out to be wrong.

This was not a get out of jail free card because if the taxpayer had reason to believe that the professional adviser may not be correct, he cannot just close his eyes to those doubts and hide behind the adviser.

This was perhaps taken too far in *Stratton v HMRC* TC 2967, where the tribunal concluded that where the professional advice was based on a simple failure to consider the relevant statutory provisions, the taxpayer could not rely on such defective advice to provide him with a reasonable excuse. This is extremely harsh because no lay taxpayer can sensibly know whether the advice is defective or whether the adviser considered the relevant statutory provisions and this would seem to undermine the entire protection which was valued so highly in *Mariner*—and in the rather impressive list of similar authorities.

Another dimension

The more recent decision in *Litman and Newall v HMRC* TC 3039 has added a new dimension to the taxpayer's difficulties—at least where he has entered into a tax

scheme. The taxpayers participated in a scheme to provide them with a capital loss. They were professionally advised and acted in accordance with the advice, including in their tax returns the DOTAS number in respect of the scheme.

> *"I think there is a "playing with fire" agenda here and I have a feeling that this is only the beginning"*

The tribunal confirmed that a taxpayer who reasonably relies on a reputable adviser for advice in respect of his tax affairs will not be liable to a penalty. The taxpayer could not be expected to understand the legal and tax implications of the complex arrangements and could properly rely on his professional advisers. The test to be applied is "what a reasonable taxpayer exercising reasonable due diligence would have done".

The question is, of course, what is meant by reasonable due diligence in these circumstances. The tribunal concluded that the level of due diligence required of a taxpayer regarding the technicalities to such a scheme is when professional tax advisers are involved. However, this did not extend to the commercial aspects of the arrangements. One of the elements of the arrangement involved the advancing of a loan to the taxpayer which was subsequently repaid. There was no evidence that any money was ever lent or that it was ever repaid. The tribunal said the taxpayers were negligent in signing their tax return which reflected loans which they had no evidence had ever been advanced or repaid. No amount of advice from their advisers could remove the obligation for the taxpayer to consider whether the proposed transactions stood up to a basic level of commercial scrutiny.

A life less ordinary

While there are some helpful elements to this judgment for the ordinary taxpayer undertaking ordinary commercial transactions, there is clearly a stricter rule for those who participate in tax schemes. The facts of this case may be special in having regard to the shortage of evidence but the question arises as to how much of the arrangements does the taxpayer have to understand for him to be protected from a charge of negligence.

It would seem that the lay taxpayer is obliged to understand the commercial aspects behind all these complex arrangements so that he can assess whether they stand up to commercial scrutiny. What if he does not understand them? Or what if he makes specific enquiries of his advisers to confirm that the arrangements have been properly implemented? Of course, the taxpayer cannot hide behind obviously duff advice but the fact that the taxpayer does not understand the commercial features of a complex scheme surely cannot make him negligent. I think there is a "playing with fire" agenda here and I have a feeling that this is only the beginning.

Hey big spender!

The tribunal recently had occasion to consider the meaning of enhancement expenditure for capital gains tax purposes under Taxation of Chargeable Gains Act 1992 (TCGA 1992) s 38(1)(b) in the case of *Blackwell v HMRC TC 3243*.

At the risk of oversimplifying things, Mr Blackwell was proposing to sell shares in his family company. He entered into certain agreements regarding the possible sale of his shares but a little while later a third party offered him a great deal more. This placed him in difficulty in respect of the earlier agreements. So he ended up making a payment of £17.5m to get out of the earlier agreements so that he could accept the higher offer for the shares. In computing the capital gain on the sale of his shares he claimed a deduction for the £17.5m which had put him in a position to proceed with the sale.

Instinctively one feels that a deduction should be permitted for this expenditure, but the terms of s 38 are not helpfully worded for this circumstance. To be entitled to relief he had to show that the expenditure was incurred on the asset "for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of disposal".

Mr Blackwell believed (with good reason) that the expenditure would enhance the value of his shares because it would enable the higher bid to be accepted. However, it is not enough just for the expenditure to enhance the value of the asset; it is necessary for the expenditure to be reflected in the state or nature of the asset. HMRC argued that there was no change in the state or nature of the shares: they were merely able to be sold at a higher price. Furthermore, the payment was actually to release Mr Blackwell from various undertakings and was not expenditure on the shares at all.

However, the tribunal decided that the expenditure was incurred on the shares in the sense that it was incurred in respect of the shares and for the purpose of enhancing their value. It also concluded that the state of the shares was different by reason of the payment because, having been released from his obligations, Mr Blackwell became free to vote as he wished without risk of litigation for breach of contract.

> *"The taxpayer must provide the necessary information to HMRC so that a hypothetical tax officer will have sufficient awareness of the position"*

I imagine that there will be a number of people finding it difficult to follow this reasoning and will conclude that it is only the brilliance of counsel for the taxpayer which enabled the tribunal to come to such a conclusion.

One could understand if the decision had been made (as counsel for the taxpayer urged) on the basis of a purposive construction of the legislation. This would have been welcome because such purposive constructions in the taxpayer's favour are few and far between. However, the tribunal expressly stated that a purposive interpretation was not possible in this case—although many may feel that this was exactly the position.

Currency affairs

I never like to miss a case on discovery assessments as the rules are being refined all the time. In fact, the arguments on this subject have now become so refined that the whole purpose of the legislation is in danger of being lost. The latest such case is *Boyle v HMRC* TC 3103 which concerned a tax scheme involving loans in foreign currencies, notably Uzbekistani Soums.

The idea was that the employee was lent money in the foreign currency which he immediately converted to Sterling. However, he did not have to repay it until later when the Uzbekistani Soums had fallen in value. So he borrowed the equivalent of £100 today and could repay it next year in the foreign currency by which time it would be worth only £40. Nice idea—and there are some really good reasons why this difference is not taxable. (I seem to remember this being a popular idea about 25 years ago when the Turkish Lire went into decline. It got a lot less popular when the Turkish Lire recovered). Anyway there were various aspects of Mr Boyle's arrangements which caused the tribunal to find that it was taxable as earnings.

The interesting issue was whether HMRC could raise a discovery assessment—and as usual it came down to the information Mr Boyle had provided. The tribunal drew attention to the fact that there was no information contained on Mr Boyle's tax returns regarding the various loans and they had little hesitation in declaring the discovery assessment valid. However, the reasoning looks a little extreme not least because it relies on passages from *Langham v Veltema* [2004] EWCA Civ 193 without any of the modifications which have been placed on that decision by the courts in subsequent cases.

The taxpayer must provide the necessary information to HMRC so that a hypothetical tax officer will have sufficient awareness of the position. But the tribunal said that information provided by the taxpayer or on his behalf is only within s 29(6) if it is provided for the purposes of an enquiry into the return and not if it is provided for some other purposes. Furthermore, there is no obligation on the hypothetical tax officer to see what information has been provided to the actual officer who has been dealing with the matter. We already know that information provided by others to HMRC does not count either.

This is getting silly. The taxpayer may have provided absolutely comprehensive information about the arrangements and HMRC may be wholly aware of every relevant fact and implication—but HMRC are apparently entitled to disregard all of this unless he sends it all to them again.

If that is not bad enough—who does he send it to? Obviously he cannot send it to the hypothetical officer because he does not exist but if he sends it to the real officer, the hypothetical officer is not assumed to be aware of it. It is about time this absurdity was sorted out to restore some common sense—and to provide the proper protection for the taxpayer (and for HMRC) for which the legislation was intended. NLJ

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