Comment

Views on topical issues

Lansdowne & discovery assessments#

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The Court of Appeal decision in *Lansdowne* restricts, significantly, the scope of HMRC's discovery assessment powers where the taxpayer's liability turns on a question of law.

In *HMRC v Lansdowne Partners Limited Partnership* [2011] EWCA Civ 1578, the taxpayer partnership (LPLP) lost the substantive issues in the case, leaving the final issue as to whether the discovery amendment to LPLP's partnership return was valid. The amendment was made under TMA 1970 s 30B(1) (the equivalent provision for individuals is s 29) on 27 August 2008. It was common ground that the enquiry window ended on 31 January 2007, and that HMRC 'discovered' that the profits in LPLP's partnership statement were insufficient on 1 May 2008. The question was whether HMRC satisfied the condition in s 30B(6) that, at the end of the enquiry window, a hypothetical HMRC officer 'could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of [the insufficiency]'. 'Information made available' to the officer is defined by s 29(6). The Court of Appeal (CA) held that HMRC did not satisfy the condition, and so the assessment was invalid.

The CA decision is important for two reasons. First, the Court held that information given to HMRC orally could not fall within s 29(6)(*d*)(ii), but if HMRC sent a written note of the information to the taxpayer, and the taxpayer adopted that note in written correspondence, then the information contained in the note could constitute 'information made available' to the hypothetical officer. This highlights the importance of acknowledging and correcting any meeting notes produced by HMRC.

Second, the CA rejected HMRC's argument that a hypothetical officer could not have been 'aware' of an insufficiency, at the relevant time, because the amount of LPLP's profits turned on a question of law that could only be resolved, conclusively, by the courts. This approach, if correct, would have drastically qualified the restrictions on HMRC issuing discovery assessments where the liability of taxpayers turns on questions of law.

The CA held that in such situations it was not necessary that a hypothetical officer would have been 'certain' or 'reasonably certain' that there was an insufficiency for HMRC to fail to satisfy the condition in s 30B(6). Moses LJ stated that 'the question is whether the taxpayer has provided sufficient information to an officer, with such understanding as he might reasonably be expected to have, to *justify* the exercise of the power to raise the assessment.' It would appear that an officer would be 'justified' in raising an assessment if she held an objectively reasonable view that there was an insufficiency in a return – thus significantly limiting the circumstances in which HMRC can rely on s 30B(6) to raise an assessment.

The CA decision is a welcome rebuff to HMRC's attempts to stretch their discovery assessment powers beyond breaking point.

For a recent article on discover assessments, see 'Discovery assessments post-Hankinson' (Hartley Foster & Louisa Warburton), Tax Journal, dated 3 February 2012.

HMRC's guidance on ACTA applications

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HMRC has published revised guidance on making Advance Thin Capitalisation Agreement (ATCA) Applications. Despite dramatic changes in the world of corporate financing, HMRC's revised guidance largely maintains its existing practice. This may reassure businesses which have an existing ACTA or are thinking of applying for one.

HMRC's revised guidance on ACTA applications, ie, on agreements between HMRC and the taxpayer as to what constitutes an acceptable arm's length position concerning related party debt, is contained in *Statement of Practice SP* 1/12, published on 3 February 2012, replacing *SP 4/07.* Readers may recall that around the time that *SP 4/07* was published, in the summer of 2007, the phrase 'credit crunch' was first being heard. Before then banks seemed to be lending to virtually anyone, government debt was typically considered to be risk free and ratings agencies only featured in the finance pages of the media. Few would have guessed then that five years later and the position would have turned full circle.

In view of the turmoil in credit and economic markets it might at first blush be considered surprising that the ATCA process and HMRC's approach to thin capitalisation have changed so little. On reflection however this should not be the case. After all, the statute itself remains relatively unchanged (although it now sits in TIOPA 2010). Also, HMRC would argue that the fundamentals measures of borrowing capacity remain the same and that the ATCA process simply reflects an arm's length agreement between an unconnected borrower and lender (albeit with rather different financial covenant levels than in 2007).

Particular changes that are noteworthy include:

- the inclusion of TIOPA 2010 references;
- reconfirmation of the type of financing arrangements included (intra-group loans, quoted Eurobonds and indirect participation 'acting together');
- the removal of some of the transfer pricing theory in *SP 4/07*; and
- the updating of practical information which should increase the chances of a successful application – who to send it to, when to send it, what information to include.

SP 1/12 also includes a model agreement that is similar to the previous one published by HMRC. Whilst this is largely unchanged, one point worth noting is that further detail has been provided by HMRC regarding circumstances that lead to the business failing to meet the financial conditions in the ATCA due to an exceptional event.

This is important because failure should in principle mean a disallowance of interest. Therefore the inclusion of details when such a disallowance may not be applied by HMRC could be useful to a business that has entered into an ATCA but has failed to meet the compliance conditions due to unforeseen circumstances.

In conclusion, *SP 1/12* largely maintains HMRC's approach and practice on ATCAs – one of the few constants in the world of corporate financing since the last one was published.

UK's abolition of mistake of law remedy challenged by the EC

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The European Commission is right to refer the UK to the CJEU for abolishing the remedy for repayment of taxes paid in mistake of law without proper transitional rules.

The UK retroactively abolished the mistake of law remedy in FA 2007 s 107. On 26 January the European Commission announced it had decided to refer the UK to the European Court of Justice because the UK has refused to reverse that abolition.

In the UK, until the enactment of FA 2007 s 107, there were arguably four ways in which an offended person could obtain repayment of charges levied in breach of community law.

The first is a statutory error or mistake claim. Following *Autologic Holdings plc & Ors v. Commissioners of Inland Revenue* [2005] UKHL 54 it is settled law that this route should be pursued where available.

The second is a claim for damages for serious breach of Community law (commonly called a *Francovich* claim following joined cases C-6/90 and C-9/90 *Andrea Francovich and Danila Bonifaci and others v Italian Republic*). Given the continually evolving understanding of the rights and duties of persons and Member States it is rare for breaches to be sufficiently 'serious'.

The third is a claim for restitution of tax unlawfully demanded (known as a *Woolwich* claim following *Woolwich Equitable Building Society v IRC* [1993] AC 70). *Woolwich* claims are, broadly, subject to a six year limitation period.

The fourth was by a claim for restitution based on mistake of law (known as *DMG* claims following *Deutsche Morgan Grenfell v Inland Revenue & Anor* [2006] UKHL 49). *DMG* claims were subject to the extended limitation period under the Limitation Act 1980 s 32(1)(*c*) (which broadly provides that a person has six years from the date of the discovery of the mistake to bring a claim). This peculiarity made the possibility of *DMG* claims a valuable one in situations where statutory remedies were not available or relevant time limits had expired- as is the case with many EU group litigation claims. It was to prevent such a remedy being available in respect of EU tax claims that s107 was enacted.

The Commission's view is contrary to that of the Court of Appeal in the Franked Investment Income GLO (*Test Claimants in the Franked Investment Income Group Litigation v HMRC* [2010] EWCA Civ 103). The Court of Appeal had found that a *Woolwich* claim allowed a taxpayer to reclaim tax charged under an unlawful provision and so the right to a *DMG* claim was not necessary to protect the taxpayer's EU rights. Accordingly s 107 survived.

With respect, I believe that the Commission is right. The principles of legal certainty and legitimate expectation prevent any existing limitation period applicable to an EC law right being shortened without a transitional period.

The taxpayer's appeal from the Court of Appeal on the remedies issues will be heard in the Supreme Court from 21 February. Should the Supreme Court find that, as the Commission argues, the mistake of law remedy should be available to the appellant, s 107 will surely fall.

The European Commission's press release can be found via lexisurl.com/uTl5l.

FATCA developments

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The regulations to implement FATCA have finally been published in proposed form, but it is a two page joint statement by the governments of key EU jurisdictions which brings FATCA implementation closer to reality.

On 8 February 2012, nearly two years after the US legislation commonly known as 'FATCA' (Foreign Account Tax Compliance Act) was enacted, the US IRS has released 388 pages of proposed FATCA Regulations. Simultaneously, the governments of the US, UK, France, Germany, Italy and Spain have issued a joint statement agreeing 'to explore a common approach' to implementing FATCA that contemplates reciprocal tax information reporting by US financial institutions.

FATCA is intended to provide the IRS with details of accounts held by US citizens with Foreign Financial Institutions (FFIs). The scheme of it is to require FFIs to sign up to disclosure agreements with the IRS or face 30% withholding on US-related payments.

FATCA has been widely criticised, generally for three main reasons. First, compliance by FFIs with their IRS agreements could breach local data protection and privacy laws and agreements with their own customers. Secondly, identifying US account holders imposes a costly burden on FFIs. Thirdly, the requirement for compliant FFIs to withhold on so-called 'passthru payments' introduces cost, complexity and commercial issues.

The Regulations, together with the joint statement, take welcome steps towards mitigating each of these issues. Under the joint statement framework, each of the five EU jurisdictions mentioned above (FATCA partners) would 'pursue implementing legislation' to require FFIs to collect information on US accounts and report it to their local revenue authorities. The FATCA partners, rather than each FFI, would then automatically transfer the reported information to the US. The FATCA partners also agree to 'enable' FFIs to apply the necessary diligence to identify US accounts. FFIs in the FATCA partner jurisdictions would not have to terminate the accounts of recalcitrant account holders. While the joint approach raises as many questions as answers, it does provide a framework for solving tricky legal issues and therefore makes implementation of FATCA feasible.

The Regulations help with the cost of account diligence mainly by limiting it primarily to electronic reviews (a least for accounts of less than US$1m).

The problem of withholding on 'passthru payments' is mitigated by the joint statement which proposes that such withholding would not be required by FFIs in the FATCA partner jurisdictions on payments to 'recalcitrant account holders' or to FFIs in other 'good' jurisdictions.

Certain transactions entered into before 18 March 2012, the second anniversary of the FATCA legislation, benefit from 'grandfathering' provisions which should in general exempt them from the withholding provisions of FATCA. The Regulations effectively extend this grandfathering provision to 1 January 2013 and push back a number of other important parts of the FATCA implementation timetable.

The anticipation of detailed FATCA guidance is over but it seems that the ending to the FATCA story will continue to remain a mystery for now.

For the draft regs and the joint statement, see lexisurl.com/hh651.