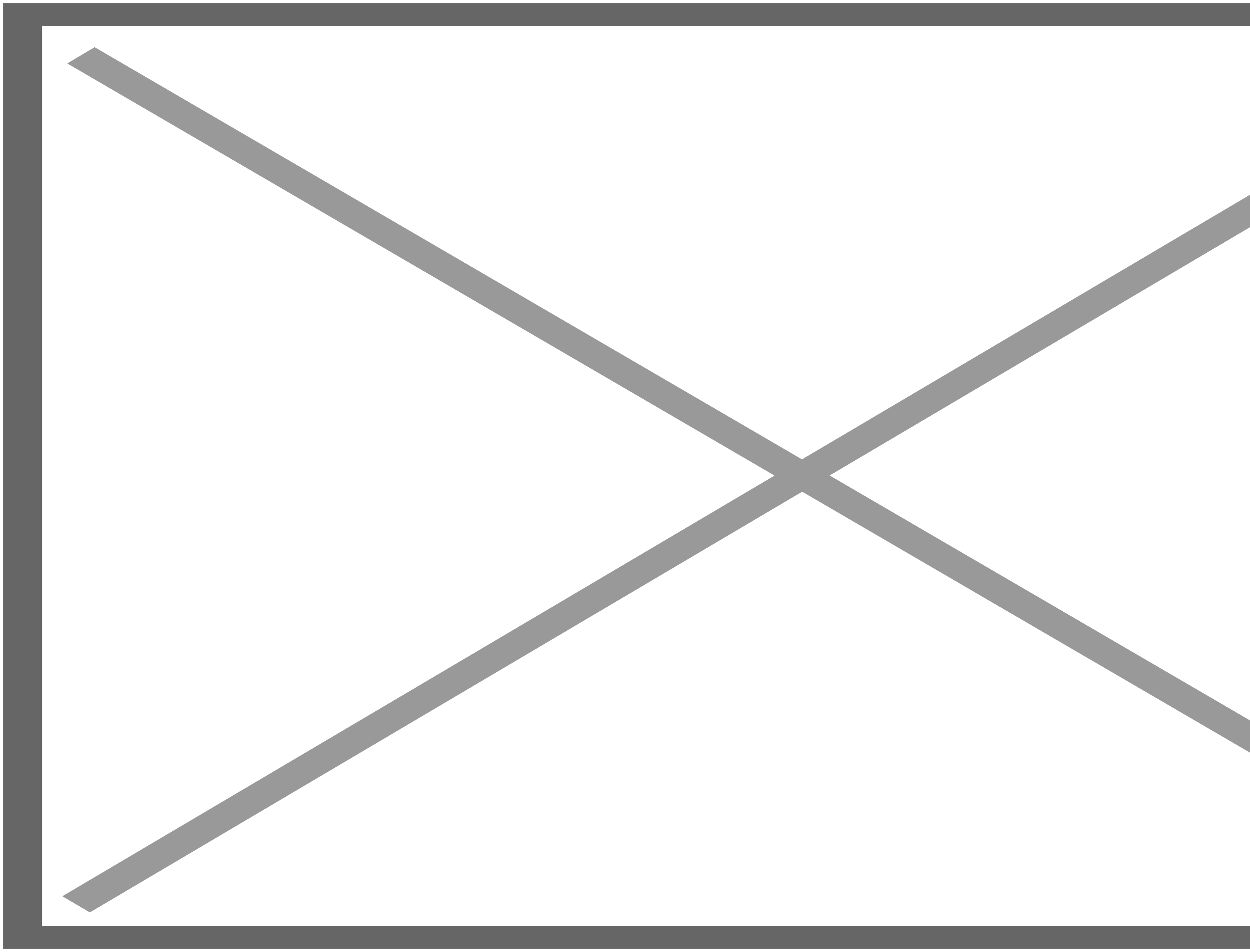
DOTAS or not to DOTAS – that is the question

Management of taxes



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Keith Gordon considers the decision in a recent judicial review of a Partner Payment Notice where the partnership had claimed a Business Premises Renovation Allowance

Key Points

What is the issue?

Is a DOTAS disclosure necessary when making a tax-incentivised investment?

What does it mean to me?

Could I get an APN or PPN in cases where HMRC are challenging investments which take advantage of a tax relief specifically introduced by Government to encourage such investments?

What can I take away?

The boundary between tax planning and tax avoidance is now even more blurred.

For the past decade or so, HMRC's stated ethos has been to collect the maximum amount of tax. So much so that the old adage of 'care and management' has been replaced by the current maxim of 'collection and management' (even though, buried away in an interpretation provision, the latter is then defined to mean the former). In recent years, the emphasis has now started to shift towards quicker payment as well. This can be seen in one respect by the rules that seek the payment of capital gains tax within 30 days of a transaction (a process that has been introduced in stages over several years). However, another aspect, which has been keeping many professionals (me included) busy in recent years, is the introduction of the Accelerated Payments regime (encompassing Accelerated Payment Notices (APNs) and their alter egos for cases involving investments through partnerships, Partner Payment Notices (PPNs)).

The stated purpose of the APN regime is to allow HMRC to demand the tax in dispute upfront (ahead of the resolution of any enquiry and/or litigation), ostensibly in response to some taxpayers delaying the enquiry/litigation process so as to defer for as long as possible the ultimate obligation to pay the tax in dispute. From my own experience, I do not recognise the premise as I have never seen taxpayers drag out enquiries/litigation: on the contrary, it always seems to be HMRC who have no interest in resolving matters and, even when timetables are eventually agreed, HMRC often seek to extend them. Furthermore, the APN regime (which has allowed HMRC to pocket the tax) seems to have made HMRC even more reluctant to allow any underlying investigation to come to an end.

That said, the APN rules are not to be of general application but operate in only certain scenarios: where there has been a follower notice, where the arrangements have been notified, and are actually notifiable, under the Disclosure of Tax Avoidance Schemes ('DOTAS') rules or where there has been a prior decision of the GAAR Panel (with two or three panel members upholding a finding of abuse). The common theme within each of these is the concept of avoidance: follower notices may be issued only when the obtaining of a tax advantage is a main purpose of the arrangements, DOTAS is governed by a similar provision and abuse is clearly a subset of avoidance. The main question that arose in *R (oao Carlton) v HMRC* [2018] EWHC 130 (Admin) is when does a set of arrangements have avoidance as a main purpose.

Background to the case

Since the Finance Act 2014 was enacted, there has been a steady trickle of judicial reviews challenging the issue of APNs and PPNs. The challenges have been mainly unsuccessful. However, the main issue in those cases has broadly been to challenge the use of the legislation in relation to historical arrangements: effectively, are HMRC allowed to move the goalposts after the event?

Whilst other challenges have been made, most cases have been stayed behind the *Rowe* case (*R (oao Rowe) v HMRC*) which was finally disposed of by the Court of Appeal late last year – on the basis that, had Rowe succeeded, the lawfulness of the entire regime would have been doubted. The *Rowe* case has certainly identified some flaws with HMRC's application of the rules, although what was inflicted on the regime was considerably less than a fatal blow. Consequently, the various case-specific issues are going to emerge in the coming months as the previously-stayed cases start to get heard by the Administrative Court.

The first of these was *Carlton*.

Facts of the case

Mr Carlton was a member of a limited liability partnership which had invested in commercial property qualifying for the business premises renovation allowance ('BPRA'). The BPRA is effectively a rebranding of the old Enterprise Zone Expenditure rules (which piggy-backed the former Industrial Buildings Allowance rules). It is designed to subsidise (through generous 100% capital allowances) the investment and development of properties in designated deprived areas. In other words, Government has recognised that the investment would not otherwise be attractive to an investor and, so, has made it commercially viable by offering a tax break.

As was common, the investment was duly notified to HMRC under the DOTAS rules. HMRC themselves recognise that many notifications were not strictly necessary. However, notifications were frequently made as a precaution, given the high penalties that exist for non-disclosure.

The LLP invested in a potential hotel site on 25 March 2011 with 84 investing members. The property was renovated and the hotel duly opened for business in July 2012. The LLP claimed BPRA in relation to expenditure of £12.4m in its 2011 tax return, which was subsequently subject to an enquiry. Inevitably, the upfront capital allowance gave rise to a trading loss for the LLP and its members were then entitled to set off their share of the loss against other taxable income. Indeed, that is precisely how the tax rules should operate.

It is unclear as to why the enquiry continued into 2015, but it did. As the FA 2014 rules had now come into force, HMRC felt empowered to issue PPNs, seeking to block 30% of the claimed losses. In early 2016, the enquiry closed, and the LLP's appeal was due to be heard by the First-tier Tribunal in May of this year.

The main issue in *Carlton* was whether the arrangements fell within the definition of 'DOTAS arrangements' so as to justify the issue of the PPNs. This in turn required the Court to consider whether or not the BPRA investment entered into was required to be notified under the DOTAS rules. (The irony of the APN/PPN rules is that even when there was a duty to notify under DOTAS, non-disclosure would keep the arrangements outside the APN/PPN regime.)

The High Court's decision

The Judge (Mrs Justice Whipple) considered the rules concerning the obligation to notify arrangements under DOTAS. They are principally covered by the Finance Act 2004, section 306(1). Most importantly, section 306(1)(c) requires the arrangements to have as the or a main benefit the obtaining of a tax advantage, and section 306(1)(a) requires the arrangements to come within one or more of what are generally known as the hallmarks of avoidance (the various characteristics of avoidance schemes as set out in the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543)). HMRC were relying on the 'Loss schemes' hallmark in regulation 12. At the time, that caught arrangements where (objectively) it would seem that 'that the main benefit of those arrangements which could be expected to accrue to some or all of the individuals participating in them is the provision of losses', where such losses would be used to reduce an income or capital gains tax liability.

The Judge duly compared the value of the expected loss relief with the prospective return on the LLP's investment. In doing so, the Judge deliberately ignored as irrelevant the capital investment. As a result, the expected loss relief was a sizeable part of the financial return and therefore was considered to be the main benefit of the arrangements. The Judge accordingly held that the loss schemes hallmark was met in the present case.

Given the similarity of the tests, the Judge duly concluded that the condition in section 306(1)(c) was also met, meaning that the arrangements were held to be notifiable under DOTAS.

Accordingly, the Judge held that HMRC had been entitled to issue a PPN to Mr Carlton and the judicial review claim was refused.

Commentary

In my respectful opinion, this is a worrying decision and one that I hope will be closely examined on appeal. When interpreting the loss schemes hallmark, the Judge explained her thinking thus: 'The whole point of the APN regime is to shift the burden of the tax onto the taxpayer …' That statement is undoubtedly true, but it is wholly irrelevant to the question as to how the DOTAS code should be interpreted. After all, DOTAS (when introduced) was designed for one purpose wholly separate from APNs. Indeed, until the introduction of the APN legislation ten years later, there was no downside about precautionary disclosures: promoters had nothing to hide and could protect themselves from the risk of swingeing penalties. The introduction of the APN regime has simply caused grief for such 'over'-compliant promoters (and their clients), leaving the less cautious to escape the APN code (at least until a follower notice might become a possibility).

The point about the loss schemes hallmark is that it is there to catch the various arrangements which, following a few paper transactions, a loss pops up which the taxpayer can use to set off against income or capital gains. It is inconceivable that it should catch an arrangement where (as here) an investment has been subsidised by central Government via the availability of an allowance which gives rise to a trading loss, so as to make the investment viable. Can one really say that the loss is the (or even a) main benefit of the arrangement? It is surely merely an incentive, a subsidy, to facilitate the investment. Unlike the true loss schemes, where the taxpayer ends up with nothing other than a paper loss (and possibly a few pounds income), Mr Carlton ended up with a share of a hotel.

I cannot see any justification for the Judge's approach which was to exclude the capital investment from the exercise. Using wholly different numbers to illustrate the point, if I part with £100 for an asset worth £110 (because of, say, £10 worth of tax relief) and expect to sell the asset five years later for £120, what is the main benefit of my investment? Surely it is an asset worth £110 (and the hope of a further £10 profit). I cannot ignore the fact that I have parted with the £100 in the first place and, for the same reason, should not ignore the fact that I end up with an asset worth £110 (or so).

Or, to look at it another way, if a 45% taxpayer puts £1000 into a pension scheme, what is the main benefit of the investment? I would say that the main benefit is the additional £1000 sitting in the pension pot. It would be rather strained to say that the £450 tax relief was any more than an inducement.

Furthermore, the Judge's reliance on the First-tier decision in *Brain Disorders Research LP v HMRC* [2015] UKFTT 0325 (TC) to support her conclusion appears to have missed the point of that case. There, the expenditure was inflated for no commercial reason, other than to maximise the tax relief.

What to do next

I do not expect this case to have a major impact on other outstanding judicial reviews in relation to APNs and PPNs issued in relation to other arrangements that rely upon the availability of capital allowances: those judicial reviews are likely to proceed in the normal way, giving the Court (and/or, in due course, the Court of Appeal) a further opportunity to consider the meaning of the main benefit test.

However, although the context of the case was the APN/PPN legislation, the actual effect of the decision was to interpret DOTAS. The cautious response to *Carlton* would be now to consider notifying HMRC of all historical arrangements where a tax relief has incentivised a wholly commercial investment and hope that HMRC will view the late disclosure with favour so far as penalties are concerned. After all, *Carlton* says that they should have been notified in the first place and therefore a risk of penalty is now (at least in theory) a possibility. I do not, however, expect this to happen; mainly, because I suspect that most advisers will take the view that *Carlton* was wrongly decided.
It should be noted that the hallmarks have since been revised and the loss schemes hallmark has been broadened.