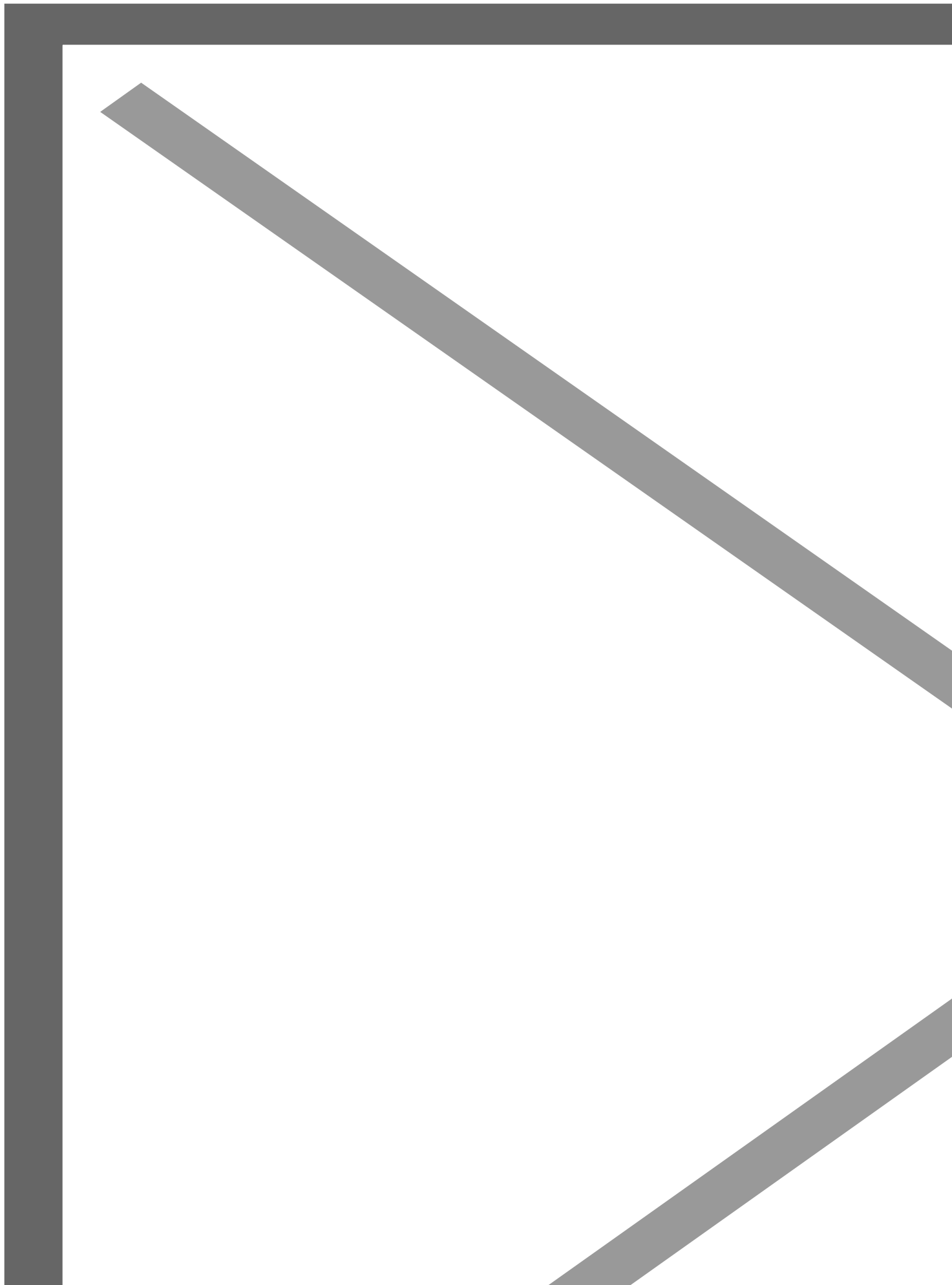
I have a tax dream

Management of taxes



04 December 2015

Rory Mullan explains that the approach of HMRC is at odds with that of the European Court of Human Rights

Key Points

What is the issue?

Human rights are increasingly important in tax disputes so it is important to know when they can be asserted, particularly in penalty cases

What does it mean to me?

Human rights law imposes obligations on HMRC, including the requirement of a clear legal basis for their actions. In penalty cases, the convention requires that underlying law should be clear and the burden of proving liability will be on HMRC

What can I take away?

All penalty cases are protected by the convention, despite HMRC's view to the contrary. As such, when dealing with these cases, the potential relevance of the convention is to be borne in mind

Human rights law is playing an increasingly important role in tax matters. As HMRC's powers have expanded – such as the right to deduct money from a taxpayer's bank account – and the range of penalties has increased – those for the new offshore evasion offences, for example – a real threat to the rights and freedoms guaranteed under the HRA 1998 and elsewhere has emerged. It has become increasingly necessary, therefore, to be in a positon to assert and rely on those rights.

Sources of human rights law

The main source of human rights law in the UK is HRA 1998. This incorporates the Convention for the Protection of Human Rights and Fundamental Freedoms as it has effect in relation to the UK (the convention) by requiring public authorities, including HMRC, to act in accordance with it, HRA 1998 s 6, and requiring legislation to be construed compatibly with it so far as possible, HRA 1998 s 3.

The second important source of human rights law is the Charter of Fundamental Rights of the European Union (the charter). A limitation on the charter, however, is that it is binding only on member states when they are acting within the scope of EU law (Article 51 and the explanation relating to the charter (2007/C 303/02)). Although it will apply fully in relation to VAT matters (*Aklagaren v Hans Akerberg Fransson* C-617/00), the scope of its application elsewhere is unclear.

Importantly, the charter offers more protection than the convention in two ways.

First, although tax disputes are outside the scope of the right to a fair trial in Article 6 of the convention (*Ferrazzini v Italy* (2001) 34 EHRR 1068) they are within that of the equivalent provision in Article 47 of the charter (*ToTel Ltd v RCC* [2015] STC 610).

Second, the charter has direct effect in UK so that a tribunal is bound to abide by it, even in the face of inconsistent UK legislation (*Benkharbouche v Embassy of the Republic of Sudan* [2015] 3 WLR 301). In contrast, a tribunal is required to apply legislation even when it breaches the convention. For example, in *Dyson v RCC* [2015] SFTD 529, the First-tier Tribunal (FTT) held a breach of the right to a fair trial in the denial to a partner of the right to appeal against a penalty. However, as it was not possible to interpret the legislation in a way that gave effect to that right, the tribunal had no option but to strike out the appeal.

Provisions of the convention and charter relevant to tax matters

A provision of the convention often engaged by tax legislation is Article 1, Protocol 1 of the convention (A1P1) – the right of an individual to have peaceful enjoyment of their possessions. It is established that the levying of taxes will, in principle, come within A1P1 (*NKM v Hungary* [2013] STC 1104), although see *APVCO 19 Ltd v HMT* [2015] EWCA Civ 648 at 46 as to whether an arguable right to a relief is a possession.

Another relevant right is contained in Article 8. Nominally that Article is concerned with the right to respect for private and family life, a person's home and correspondence. But in *Bernh Larsen Holding AS v Norway* (Application No 24117/08) (2013) 35 BHRC 224, the European Court of Human Rights (ECHR) held that, when Norwegian revenue exercised owers demanding information of particular companies, it was subject to Article 8. The expression 'home' could include a company's business premises and the information could fall within the meaning of correspondence.

Although these rights are not absolute, any provision infringing on them must have a legal basis. This requires that the applicable law be adequately accessible and foreseeable and must offer protection against arbitrary interferences by public authorities. It must also pursue a legitimate aim and be proportionate (albeit a wide margin of appreciation is afforded states in relation to this latter point).

Criminal matters

Various convention provisions apply to 'criminal' matters. That does not mean criminal under UK law but it has an autonomous definition that includes tax penalty proceedings.
The three criteria that the ECHR has adopted to determine whether a matter is criminal are derived from *Engel v Netherlands* (No 1) (1976) 1 EHRR 647:

i) the classification of the proceedings in domestic law;

ii) the nature of the offence; and

iii) the nature and degree of severity of the penalty.

These criteria have often been considered in relation to tax penalties. Most recently, in *Österlund v Finland* (Application No 53197/13), the ECHR echoed what it had previously said in setting out the position in the following terms:

> 'The court has taken a stand on the criminal nature of tax surcharges, in the context of Article 6 of the convention … the court observed [in Jussila v Finland] that the tax surcharges were imposed by general legal provisions applying to taxpayers generally. Further … the tax surcharges were not intended as pecuniary compensation for damage but as a punishment to deter re-offending. The surcharges were thus imposed by a rule, the purpose of which was deterrent and punitive. The court considered that this established the criminal nature of the offence. Regarding the third Engel criterion, the minor nature of the penalty did not remove the matter from the scope of Article 6.'

It can be seen that the decisive point is not their classification nor the size of the penalty, but that they are applied generally and are intended as a punishment for non-compliance.

HMRC's view as set out in their *Compliance Handbook* at paragraph CH300200 is not consistent with this. HMRC state (without reference to the ECHR's applicable case law) that only some tax penalties will come within the autonomous convention meaning of criminal and this depends on the severity of the penalty:

> 'We accept that penalties are 'criminal' for Article 6 purposes where the maximum potential penalty is 70% or more of the amount we use to calculate the penalty…
>
> 'We do not accept that any other HMRC penalties are subject to Article 6 of the ECHR.
>
> 'This means that the majority of tax-geared penalties (but not fixed penalties) must be treated as if they are subject to Article 6 ECHR because the maximum penalty percentage rate could be 70% or more.
>
> 'Penalties under FA 2007 Sch 24 para 2 are an exception. The maximum tax-geared penalty chargeable is 30%...'

The First-tier Tribunal rejected this view in *Bluu Solutions Ltd v RCC* [2015] UKFTT 95 (TC) which concerned a 1% penalty. HMRC argued that this was not criminal for convention purposes because it did not meet the 70% threshold set out above.

The tribunal (Judge Redston and Mr Speller) considered the case law of the ECHR and domestic authorities, concluding: 'A tax penalty, which is meant to be punitive and to deter, is "criminal" for the purposes of Article 6.' (Paragraph 65.) It also rejected an argument based on the surprising proposition that penalties intended to change behaviour were not punitive.

This decision was undoubtedly correct and defines an important level of protection for taxpayers faced with HMRC penalties. Not only is Article 6 – right to a fair trial – engaged (it has no application in a normal tax appeal), it applies in an extended manner. This requires that the taxpayer is presumed innocent, the burden of proof will be on HMRC, proceedings have to be brought within a reasonable time, and the taxpayer must have enough resources and time to defend against the penalty.

However, Article 6 is not the only provision in point. Article 7 requires that any penalty should have a clear basis in law (*Kokkinakis v Greece* (Application No 14307/88)). As such, if there is genuine uncertainty as to the underlying tax law, it may be a breach of Article 7 to seek to impose a penalty based on non-payment.

The charter offers further protections – Article 49 imports an express requirement of proportionality that is directly effective and may afford a narrower margin of appreciation than would be the case under the convention. Further, Article 50 grants the right not to be punished twice in criminal proceedings for the same conduct.

Conclusion

Human rights law is an important source of protection in relation to tax matters. This is particularly so in relation to those that would be classified as criminal under the convention. The FTT has rightly rejected HMRC's approach which is at odds with that of the ECHR. Taxpayers should be aware of the rights that flow from human rights law in dealing with penalty cases in particular.