# Joost Busters

Personal tax

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Keith Gordon discusses a case where the income tax charge is completely disproportionate to a taxpayer’s income

## Key Points

## What is the issue?

By rejecting the human rights ground of challenge, the Lobler decision suggests that HMRC have more or less unfettered powers to assess taxpayers on the basis of a

strict application of the legislation

## What does it mean for me?

HMRC argued that Mr Lobler had been careless when completing the withdrawl form and he should have taken advice at that stage. The judge rejected the argument saying that ‘one does not seek advice on everything’

## What can I take away?

The judge’s comment should be applied in all sorts of cases where HMRC start alleging carelessness when taxpayers make errors due to a failure to take professional advice at the relevant time

The largely well-meaning public debate on tax avoidance makes frequent reference to the intention of parliament and whether a taxpayer’s actions have somehow frustrated those intentions. The terminology used in this debate, and the examples cited, are unhelpful, because the intention of parliament is a phrase that has a specific legal meaning. In particular, as emphasised by the *House of Lords in R v Secretary of State for the Environment, Transport and the Regions and Another, Ex Parte Spath Holme Ltd* [2001] 2 AC 349, ‘the overriding aim of the court must always be to give effect to the intention of Parliament *as expressed in the words used*’ (my emphasis).

Therefore, it is usually a sterile approach to focus on the policy behind a particular statute or the thinking of the minister promoting a particular enactment – or that of the relevant parliamentary drafter or even the official instructing him or her – when trying to ascertain parliament’s intention, because that intention is solely reflected by the words employed in the statute itself.

That is not to say that the underlying policy is totally irrelevant. Indeed, the purposive approach to statutory construction positively encourages this. However, the idea that the actual words used by the statute can be ignored, simply because the outcome in a particular case is not one that the minister would have wanted, is just plain wrong.

On the other hand, concern has been expressed that the courts’ desire to defeat tax avoidance has led to judges filling in gaps left by the legislature – something that is

constitutionally dangerous. These concerns are perhaps alleviated by the introduction of the general anti-abuse rule (GAAR) in FA 2013, because that gives the judiciary the power to overcome loopholes in certain limited cases. The effectiveness of the GAAR will still not be known for several years. From a legal perspective, the GAAR means that a judge will not go too far. Putting it another way, the GAAR gives statutory backing to a judge who might otherwise be straying into the territory of the legislature. There again, the political driver for the GAAR was because, in some cases, judges would not go far enough.

This latter concern was typified by the decision of the High Court and the Court of Appeal in the case of *Mayes v HMRC* [2011] STC 1269. The case concerned the taxation of life assurance policies under the rules currently in the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) Pt 4 Ch 9. In Mayes, the courts were faced with 'a blatant tax avoidance scheme'. However, given the overly prescriptive nature of the legislative scheme and the fact that 'no overriding principle [could] be extracted from the legislation', the courts were forced to conclude that a taxpayer who had successfully navigated his way through the rules could not be subjected to a tax charge not expressly provided for by the legislation.

The present case of *Joost Lobler v HMRC* [2015] UKUT 152 (TCC), concerns the same statutory rules but with a very different outcome.

## The facts of the case

Mr Joost Lobler is a Dutch national who came to the UK in early 2004 with his wife and two young children. He sold the family home in the Netherlands for approximately £350,000 – this amount representing the entirety of Mr Lobler's life savings – and the proceeds were invested in life insurance policies administered by the insurance company Zurich in the Isle of Man.

The following year, Mr Lobler took a loan of $700,000 and invested the sum in further life insurance policies with Zurich. This took his total investment as at 1 March 2006 to $1.4 million in 100 policies. It is accepted that Mr Lobler's investments were not motivated by tax avoidance.

In 2007, Mr Lobler withdrew $746,000 from the policy to repay the bank loan, plus interest; and, a year later, a further $690,000 to finance the purchase of a new house. On both occasions, the funds were obtained by a partial surrender of each of

the 100 policies, representing in total 97.5% of the amount he had originally invested. Mr Lobler terminated the investments later in 2008, receiving some $35,000.

Under the statutory rules, a partial surrender leads to the taxpayer being taxed on income (a *deemed* gain) equal to the amount received, less 5% of the premium originally paid. Therefore, under the statutory code, Mr Lobler should be taxed on having realised income amounting to approximately $1.3 million, even though his actual (commercial) gains were significantly more modest (less than $66,000). It was noted by the First-tier and Upper Tribunals that the resulting tax charge ($560,000) would exhaust Mr Lobler's life savings and might well bankrupt him.

On Mr Lobler's appeal to the First-tier Tribunal ([2013] UKFTT 141 (TC)), the tribunal dismissed the appeal with 'heavy hearts', observing that it felt compelled by the statute to give rise to 'a remarkably unfair result'. Mr Lobler appealed against that decision to the Upper Tribunal. Because of the wider public interest in the case, the CIOT was permitted to make written and oral representations to the Upper Tribunal.

## The various arguments put forward

It was accepted that the legislation could not be interpreted in any other way. However, Mr Lobler put forward three grounds of appeal.

The first was that the tax consequences could be set aside, on the basis that Mr Lobler had been mistaken when requesting the partial surrenders of his policies. The basis of this argument was that, of the various options given to Mr Lobler on Zurich's standard form, two had more or less the same commercial results, but vastly different tax outcomes.

The second argument focused on human rights grounds and whether HMRC should be able to pursue a tax charge in such unfair circumstances.

The third argument was predicated on the assumption that the appealable decision in the present case (an amendment made by way of a closure notice) was unlawful on public law grounds. If so, the question for the Upper Tribunal was whether the First-tier Tribunal would have had jurisdiction to deal with such a challenge.

## The tribunal's decision

The case was heard by Mrs Justice Proudman, sitting as a judge of the Upper Tribunal.

**Mistake**

The law concerning mistake provides for different kinds of remedies in different situations.

In some cases, it is possible to treat a mistaken transaction as not having happened at all. However, this depends upon there being a mistake between the parties to a contract, with one party benefiting from the other's mistake. In the present case, however, Mr Lobler and Zurich were as one; and it was a third party, HMRC, that was seeking to benefit from the mistake. Therefore, the tribunal ruled that it was not possible for Mr Lobler's surrender to be set aside by reason of mistake.

The alternative remedy is to seek the court's 'rectification' of the mistaken agreement. In an ordinary contractual situation, rectification is available where the evidence points to both parties having agreed a set of terms, but where the documented agreement says something different. In such a case, the court can rectify the written document so as to record what was actually agreed. This precise analysis could not be used in the present case, because Zurich did no more than follow the instructions (mistakenly) given to them by Mr Lobler. However, a variant was proposed. It was suggested that Mr Lobler's completion of the form was a unilateral act, akin to the exercise of an option; and, therefore, only Mr Lobler's intentions needed to be examined.

This analysis was accepted by the Upper Tribunal. However, as recently considered by the Supreme Court in *Pitt v Holt* [2013] UKSC 26, the courts will intervene only in cases where it would be unjust or unconscionable not to.

Mrs Justice Proudman considered that this was a case where rectification could have applied and determined the tax position on that basis. For this reason, Mr Lobler's appeal was allowed.

**Human rights**

As a result of the decision on the rectification issue, the human rights element of the case took only secondary importance. However, the judge was aware of the wider relevance of the case (and the CIOT's consequential interest in this aspect of the

appeal).

It is well established, however, that tax legislation can be set aside on human rights grounds in only extremely limited situations. The case law refers variously to ‘a wide margin of appreciation’ and to interferences with taxpayers’ rights having to be ‘devoid of reasonable foundation’.

On balance, Mrs Justice Proudman considered that the legislation just about overcame the requirement to have some reasonable foundation. She said that: ‘The law is not irrational or arbitrary’, even though it could be fairer. Therefore, the human rights basis of Mr Lobler’s challenge was rejected.

**The role of the First-tier Tribunal**

The final ground of appeal concerned that which is becoming a regular issue in the First-tier Tribunal. Throughout the six-year life (so far) of the Tax Chamber, there has been a debate as to the scope of its jurisdiction. Essentially, the question concerns cases where a taxpayer might wish to challenge the underlying fairness of an HMRC assessment; for example, because its issue goes against a promise made by HMRC previously and breaches a taxpayer’s legitimate expectation not to be so assessed. It is generally accepted that such challenges can be made by way of judicial review (to the High Court or, in Scotland, to the Court of Session). The question is whether taxpayers can also raise such arguments in the First-tier Tribunal.

It is also generally accepted that the First-tier Tribunal does not have any inherent jurisdiction to conduct a judicial review of HMRC’s actions. There is nevertheless an argument that an appeal against an assessment (or any other decision), in cases where such an appeal may legitimately be referred to the First-tier Tribunal, may consider the wider question of the lawfulness of HMRC’s actions. This was certainly the view expressed by Mr Justice Sales (now Lord Justice Sales) in *Oxfam v HMRC* [2010] STC 686. However, subsequent decisions of the Upper Tribunal (most notably in the case of *Noor* [2013] UKUT 071 (TCC)) have eliminated any real possibility of taxpayers taking this course of action.

In the present case, Mrs Justice Proudman followed the line taken in Noor and concluded that the First-tier Tribunal could not have allowed Mr Lobler’s appeal on the basis of a challenge based on public law.

# Commentary

Although the outcome is clearly a source of relief for Mr Lobler (and his family), at least pending any possible appeal by HMRC, the Upper Tribunal's decision does not overcome the inherent unfairness in the current legislative code.

By rejecting the human rights ground of challenge, the decision suggests that HMRC have more or less unfettered powers to assess taxpayers on the basis of a strict application of the legislation, without any reason to consider the proportionality of their actions. It should, however, be noted that HMRC accepted that they will not pursue every possible tax charge, irrespective of the circumstances, and that they exercise a discretion in marginal cases. This, seemingly, was not such a case. If the case is to progress further to the Court of Appeal, it is possible that the human rights aspect of the case will gain further prominence.

In addition, the decision is a further example of the tribunals eschewing any quasi-judicial review powers in conventional appeals. Given the fact that, for most taxpayers, an appeal to the First-tier Tribunal is considerably more straightforward and cheaper than embarking upon judicial review, the *Noor* approach (as accepted in this case) is likely to put off many taxpayers from pursuing their appeals in cases where the challenge is going to be based on public law principles. Indeed, it is ironic and rather unfortunate that a taxpayer, wishing to avoid the hassle of taking a judicial review case to the High Court, is now going to have to pursue an appeal all the way to the Court of Appeal just to allow the principle to be considered afresh at a new level of the judicial hierarchy.

Except in cases such as Mr Lobler's – where the tribunal came to the rescue, having found a mistake capable of rectification – the Upper Tribunal's decision will therefore mean that taxpayers subject to the rules for life policies can continue to be charged to tax on amounts that vastly exceed their commercial gains. The overall unfairness of the situation for taxpayers is accentuated by the fact that any taxpayer who succeeds in navigating through these rules and is taxed on a sum considerably less than the commercial gain realised will now, almost inevitably, risk being caught by the GAAR.

If there were ever a case for a 'reverse GAAR' – effectively a relief for tax charges that would never have been imposed had parliament considered the matter more fully – then this case would be a leading example of when such a relief should be

granted. There is, of course, the argument that the Human Rights Act already provides for such a relief. However, the Upper Tribunal's decision in *Lobler* rejects that view.

It is currently unclear whether HMRC will seek to challenge the Upper Tribunal's decision to the Court of Appeal. There are some commentators who have suggested that the tribunal's reasoning on mistake is rather unorthodox. Alternatively, HMRC might drop Mr Lobler's case but argue that other affected taxpayers do not qualify for rectification. There remains the possibility that more will be heard in due course, either in this case or in a follow-up one.

In the meantime, there is one line from the judge's decision which will have very broad ramifications. When considering how to exercise her discretion – rectification being a discretionary remedy – it was argued by HMRC that Mr Lobler had been careless when completing the Zurich form; in particular, HMRC noted that Mr Lobler could and should have taken advice at that stage. Mrs Justice Proudman rejected that argument and applied a 'real world' approach, grounded in common sense. 'One does not seek advice on everything,' she said. This line should be applied in all sorts of cases where HMRC (with the benefit of hindsight) start alleging carelessness when taxpayers make errors due to a failure to take professional advice at the relevant time.

## Further information

Read Keith's articles '*The third and fourth steps*' on the Mayes decision from the June 2011 issue of *Tax Adviser* and '*One Futter in the grave for Hastings-Bass*' on the Futter and Pitt decision from the July 2013 issue of *Tax Adviser.*