BRIEFING

TRAVERS SMITH

Tax Investigations: Autumn Update

29 September 2020

INTRODUCTION

It was a busy and unusual summer for a number of reasons and it may be that a series of developments relating to HMRC powers, investigations and tax disputes were not top of everybody's agenda. We have therefore brought some key ones together in this update. If a theme can be teased out, perhaps unsurprisingly, it is the continued growth of HMRC's statutory powers and the courts' reluctance to interfere in the process of investigations and tax administration. That being said, a couple of recent decisions have reminded us that tax disputes do not always involve HMRC and that the drafting of "standard" tax provisions of transactional documents, although not always considered the most interesting part of the deal, can have important ramifications.

FINANCE BILL 2021 – NEW HMRC INFORMATION OBTAINING POWERS

On July 2020 the Government published draft clauses for inclusion in the Finance Bill 2021. These included several measures relating to the rules governing HMRC's ability to obtain information about taxpayers. Most significantly, the measures introduce a new form of notice – a financial institution notice ("FIN") which makes it easier for HMRC to require financial institutions (including banks and fund managers) to provide them with information about their investors and clients as HMRC will no longer be required to get the approval of the taxpayer who is the subject of the information request or the First-tier Tribunal ("FTT").

Experience has shown that if HMRC are given enforcement tools, they are likely to make full use of them. Please click **here** for the briefing we wrote shortly after the draft clauses were published in which we set out details of the new measures and what they might mean in practice for taxpayers, including concerns about whether they included adequate safeguards. Since then this issue has been picked up by the House of Lords Economic Affairs Finance Bill Sub-Committee ("the Committee") which has announced that FINs will be one of the areas of focus in its inquiry into the Finance Bill and has asked for views on them as part of a public call for evidence. The questions raised by the Committee focus on whether the proposals include adequate protection for taxpayers and whether the scope of the new power in terms of information to be reported to HMRC is appropriate and sufficiently clear. If the Committee concludes that the proposed rules lack adequate safeguards or are otherwise inappropriate or unclear, this is likely to put pressure on the Government to modify them.

HMRC'S USE OF ARTIFICIAL INTELLIGENCE IN INVESTIGATIONS

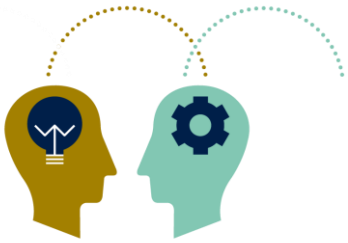
New legislation in Finance Act 2020 legislates retrospectively for HMRC to use artificial intelligence to carry out its functions. The article linked to **here** written by Hannah Manning, Sophie Lloyd and Laura Jackson, considers in particular some areas of potential concern in relation to HMRC's increasing use of automation, such as the raising of discovery assessments, business risk reviews and the assessment of discretionary penalties.

INVERCLYDE

In May, the Upper Tribunal (UT) reversed the decision of the FTT in HMRC v InverClyde Property Renovation LLP and another [2020] UKUT 161 (TCC) finding that the tax administration rules for partnerships rather than those for companies apply to limited liability partnerships (LLPs) which carry on a business. LLPs which carry on a business are generally treated the same as normal partnership for the purposes of taxation of income and gains and so the UT's decision that this should also apply to the administration provisions is not surprising.

Interestingly, in response to the original FTT decision, the Government included provisions in the Finance Act 2020 which were intended to restrict the impact of that decision with (in most cases) retrospective effect. These provisions addressed a slightly different set of circumstances to those in Inverclyde and so it is arguable, that if the original decision had been upheld, the new rules would not have worked for partnerships which are carrying on a business.

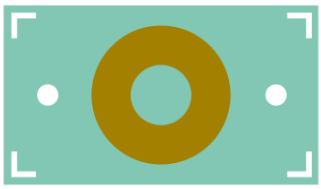
Inverclyde is a good example of the Government being willing to legislate where they do not agree with the decision of the courts and the UT decision is likely to prevent possible future disputes between HMRC and taxpayers in relation to administrative provisions applicable to LLPs.



JJ MANAGEMENT – HMRC INFORMAL QUERIES

HMRC frequently contact taxpayers to ask questions about their tax returns on an informal basis rather than under a statutory enquiry process. As the questions are informal, taxpayers can choose whether to engage with HMRC and it is perhaps this voluntary aspect that sometimes leads them to take a more relaxed approach than they would in a formal enquiry.

The Court of Appeal confirmed in June, in JJ Management Consulting LLP & Others v Revenue and Customs Commissioners [2020] EWCA Civ 784, that it is within HMRC's powers to assess tax on the basis of voluntary disclosures made by taxpayers in the course of such informal investigations. More detail about the case and our thoughts on how taxpayers should take care when responding to informal questions raised by HMRC can be found **here**.



DODIKA

Dodika Ltd (and others) v United Luck Group Holdings Ltd [2020] EWHC 2102 (Comm) dealt with whether a notification by a buyer of a claim against the seller under a tax covenant in a share purchase agreement (SPA) was valid. The SPA required notifications to state "in reasonable detail the matter which give gives rise to such Claim, the nature of such Claim and (so far as reasonably practical) the amount claimed in respect thereof…." before a contractual long-stop date.

The High Court found that the notification given by the buyer was not valid because, although it explained that the Slovakian Tax Authority was undertaking a transfer pricing investigation and gave some details of the time line of the investigation, it did not provide reasonable detail of the matter giving rise to the claim. Essentially, the court took the view that giving detail about the process of the Tax Authority investigation was not the same thing as saying what the underlying transfer pricing issue was.

The key takeaway here is to take care in the drafting of notifications for claims. Parties should go back to the relevant contract governing the terms for proper notification and ensure that all conditions are met.

AXA

In AXA SA v Genworth Financial International Holdings LLC and others [2020] EWHC 2024 (Comm), AXA had indirectly acquired from Genworth two companies that had previously mis-sold payment protection insurance (PPI). Under the terms of the SPA, Genworth had agreed to pay 90% of any PPI mis-selling liabilities payable by the two companies following completion together with a gross up obligation if those amounts were "subject to taxation in the hands of the receiving party".

The High Court held that "subject to taxation in the hands of the receiving party" meant "actually taxed in the hands of the receiving party" and that an amount under the gross up was only payable if and when the recipient was under an enforceable obligation to pay that actual tax.

This case (again) shows the need to take care in the drafting of contractual tax provisions and for the documents clearly to reflect the parties' intentions as to the allocation of tax risks. A more specific point to note is that the judgment appears to confirm that gross up clauses are likely to need additional tailored drafting if they are to apply where the potential beneficiary under the clause uses its own tax reliefs to prevent the underlying payment from being subject to tax. Without that drafting, even though the beneficiary will have borne the tax cost of the underlying payment (by preventing an actual tax liability arising by the use of its own tax assets), it seems unlikely that a court would hold that there has been any tax liability which could trigger a gross up obligation.

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