Comment

Views on topical issues

Unwarranted conduct

Jonathan Fisher QC
Barrister, Devereux Chambers

Figures released recently reveal that the number of raids on businesses and homes undertaken by HMRC's criminal investigation unit more than doubled in the last twelve months. However, as a case decided in the High Court last month demonstrates, HMRC does not always act in a lawful way. Where a raid occurs, HMRC will have obtained a search warrant in order to gain access and the key question is whether the warrant complies with the statutory requirements.

The case of *R (on the application of Anand) v HMRC and Crawley Magistrates Court*, 9 October 2012, as yet unreported, reveals what happens when HMRC blunders. HMRC was investigating whether a director of an animation film company had been guilty of serious tax fraud after the company claimed film tax relief on production costs of £3.2m but no film had ever been released. HMRC officers obtained a search warrant for the director's premises which provided that all business records, accounts, electronic storage equipment and all items believed to be of evidential value could be searched and seized. The director subsequently commenced judicial review proceedings to quash the warrant on the ground that its terms were drawn so widely that no-one would have known what items fell within its scope, other than all items found at the stated address. The High Court agreed and quashed the warrant, holding that HMRC had ignored the statutory provision requiring the identification of a class or category of documents to be covered by the warrant. The High Court said that the reason for the statutory requirement was obvious, since there had to be sufficient precision so that the person executing the warrant knew whether or not an item fell within the scope of the order. In this case, the warrant was obtained under the provisions of the Police and Criminal Evidence Act 1984. There are other cases where a search warrant is obtained under the Proceeds of Crime Act 2002, and the same principles will apply.

Unfortunately, HMRC's failure to observe statutory requirements is not unprecedented. There have been a number of cases where warrants obtained by HMRC have been quashed for a variety of different reasons. The most high profile case in recent times involved Harry Redknapp who was subsequently acquitted of tax fraud in a blaze of publicity following his trial at Southwark Crown Court. The warrant to search Rednapp's home was quashed because HMRC had not supplied to the Court sufficient information when obtaining the warrant in accordance with the statutory requirements (*Regina (Redknapp and another) v Commissioner of the City of London Police* [2009] 1 WLR 2091). The result was not unexpected, since the High Court has stressed on a number of occasions the importance of strict compliance with the statutory provisions where a serious invasion of privacy is scheduled to take place.

Mindful of the dramatic rise in the number of HMRC raids from 196 in 2010/11 to 499 in 2011/12, and with the number likely to continue rising in 2012/13, tax professionals will come across HMRC raids more often. When they do so, it is vital they check that HMRC has satisfied the statutory requirements in every respect.

Tax treaties and consortium relief

James Wilson
Senior Associate, Baker & McKenzie

The recent Court of Appeal decision in *FCE Bank* represents another nail in the coffin of HMRC's argument that the 'link company' rules in the consortium relief legislation do not conflict with the UK's double tax treaties.

In *HMRC v FCE Bank PLC* [2012] EWCA Civ 1290, HMRC unsuccessfully appealed against the decision of the Upper Tribunal that the UK's group relief rules, as they applied in 1994, contravened article 24 (the non-discrimination article) of the US/UK double tax treaty. Under the group relief rules then applicable, the 'group' relationship between the claimant and surrendering companies could not be established through a common parent company that was not tax resident in the UK. FCE Bank, in successfully claiming group relief for the relevant period, contended that this restriction contravened article 24 on the ground that the only reason for its inability to claim group relief was that its parent was resident in the USA.

HMRC's case relied heavily on certain comments of Lord Hoffman in *Boake Allen Ltd v HMRC* [2007] UKHL 25. HMRC contended that these comments were authority for the position that, as it was open to the group to avoid the discriminatory tax treatment by restructuring itself so as to interpose an intermediate UK-resident holding company between the foreign parent and the taxpayer UK-subsidiary, it could not be said that the ground of discrimination was the foreign residence of the parent. This argument was roundly rejected by the Court of Appeal.

Although this decision will be of no more than academic interest from the perspective of the group relief rules, which were amended in 2000 to enable a group relationship to be established through a non-UK resident parent, it has important ramifications in the consortium relief context. For a successful consortium relief claim to be made between a group company and a consortium company under the current rules, there must be a 'link company' that is either subject to UK corporation tax or established in the European Economic Area (EEA) (CTA 2010 s 33). For UK taxpayer companies claiming consortium relief in circumstances where their link company is resident outside the EEA, in the light of *FCE Bank* it is difficult to see how this restriction can be justified if the link company is resident in a suitable treaty jurisdiction. Indeed, this was the conclusion reached by the First-tier Tribunal, relying on the Upper Tribunal decision in *FCE Bank*, in *Felixstowe Dock and Railway Company Ltd and others v HMRC* [2011] UKFTT 838, in which the UK taxpayer company successfully argued that the non-discrimination article in the UK/Luxembourg treaty would override the link company

restriction where the link company was resident in Luxembourg (*Felixstowe Dock* related to a claim for consortium relief before the link company rules were extended to cover link companies resident in the EEA). Groups that are affected by this decision should consider making retrospective claims for consortium relief (such claims can be made up to two years after the period to which the claim relates).

A second important aspect of the *FCE Bank* decision is the rejection of HMRC's argument that treaty non-discrimination cannot arise where a group could have reorganised its affairs to remove the discriminatory treatment. This argument (as the Court of Appeal recognised) took Lord Hoffman's comments in *Boake Allen* out of context, and might have resulted in a principle that seriously undermined the effectiveness of the taxpayer protection that treaty non-discrimination provisions provide.

VAT rate shopping

Julie Park
Managing director, The VAT Consultancy

Is this avoidance?

There has been much coverage in the mainstream press and TV recently on the subject of perceived tax avoidance. The focus more recently has been on the amount of corporate tax and VAT businesses pay. The articles often demonstrated a lack of understanding about the fact that major multinationals have complex supply chains that include third party manufacturers, distributors etc, each taking a profit. Trying to make a connection between retail sales values in a jurisdiction such as the UK and the amount of corporation tax paid is therefore nonsensical.

A similar lack of understanding has arisen with VAT rate shopping. A number of B2C online businesses have been named for properly establishing in Luxemburg or France to take advantage of a reduced rate for certain sales of electronic services and infraction proceedings are looming against the Member States. Arguably this is an illogical approach given there is still such variance between standard rates within the EU – no level playing field regardless of how much tinkering is done around the edges.

The fact remains that businesses are free to properly establish themselves where they see fit within the EU and further afield. The suggestion that businesses should account for VAT where their customers are located is not unreasonable, but until the VAT system taxes transactions in this way as opposed to the place of establishment, it is a little naive to think businesses will risk being uncompetitive if operating online globally. VAT is arguably a cost retailers need to manage, and if they are able to reduce this by a few percentage points and still operate the business effectively in an overseas location, it is not difficult to see why they would do this.

The mechanics by which VAT is accounted for must be fit for purpose. Even if this is eventually achieved within the 27 EU Member States with a 'one stop shop', the EU is only a relatively small part of a much wider world, with VAT type systems pretty much everywhere but the US. Businesses still need to consider the question of how to account for VAT in the other 80+ countries worldwide where they may be trading, and they face an insurmountable VAT burden. For example, an online hotel bed bank business selling hotel rooms in every country worldwide potentially faces the following:

- VAT rules saying the supply is taxed where the hotel is located, regardless of where the business is established;
- multiple VAT registration liabilities – if it operates with a different legal entity selling global hotel rooms to consumers in its jurisdiction, the corporate group as a whole could technically be faced with 80+ VAT registrations worldwide per entity;
- if the group has, say, five entities to cover broad global regions, 400 VAT registrations; and
- each of the 400 registrations filing up to 12 returns per annum.

In practice it is unlikely such a scenario would arise but it demonstrates perfectly the fact that current VAT rules worldwide have not kept pace in a suitable way for a B2C online business. In summary they currently face being non competitive if not in a Member State with a low VAT rate, being non compliant depending on what they sell, or faced with a significant compliance burden. Until this changes, B2C businesses will surely continue to treat VAT as a P&L hit and seek to manage it in the most effective way possible, meaning they have a competitive business that contributes tax revenues.

Bruce Sutherland & Co

B W Sutherland CBE FCA FTII   Miss J A Nelder BA FCA FTII   David Bowes FTII
Moreton House, Moreton in Marsh, Gloucestershire GL56 0LH
Tel: 01608 651091   Fax: 01608 651973
DX 11484 Moreton in Marsh

bruce.sutherland@bruce-sutherland.com *jenny.nelder@bruce-sutherland.com* *david.bowes@bruce-sutherland.com*

THE SHARE VALUATION SPECIALISTS