TC05251: ANTHONY BAYLISS

[2016] UKFTT 500 (TC)

CASE REFERENCE NUMBER: TC/2015/06609
FIRST-TIER TRIBUNAL (TAX CHAMBER)

DECISION NUMBER: TC05251

APPELLANT: ANTHONY BAYLISS

RESPONDENTS: THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

TRIBUNAL CHAIRMAN: JUDGE SARAH FALK

TRIBUNAL MEMBER: MICHAEL BELL ACA CTA

LOCATION: SITTING IN PUBLIC AT THE ROYAL COURTS OF JUSTICE, THE STRAND, LONDON WC2A 2LL

DATE: 24 JUNE 2016

Capital gains tax- self assessment- penalty under s 95(1) Taxes Management Act 1970- whether incorrect return delivered fraudulently or negligently- reliance on advice as to effectiveness of capital loss generation scheme involving contracts for differences

FOR THE APPELLANTS: LAURENT SYKES QC

FOR THE RESPONDENT: SIMON BRACEGIRDLE, OFFICER OF HM REVENUE AND CUSTOMS

Decision

Introduction

1.

This is an appeal against penalties charged under s 95(1)(a) Taxes Management Act 1970 ("TMA") on the basis that the appellant fraudulently or negligently delivered incorrect self assessment returns. The alleged fraudulent or negligent behaviour relates to a claim to a capital loss in the amount of £539,000 that was included in the return for 2006/07 but which the appellant now accepts was not available. The capital loss was used to offset gains arising both in 2006/07 and in 2007/08 (with the balance carried forward unused), and penalties have been sought in respect of the tax understated in each of the two years.

2.

On the basis that the appropriate penalty percentage was 35% HMRC are seeking penalties in the amounts of £33,580 and £11,496 for 2006/07 and 2007/08 respectively, a total of £45,076. This reflects additional tax due of £95,944 for 2006/07 and £32,847.60 for 2007/08. In fact the original penalty determination in respect

of 2006/07 was in the slightly lower amount of £32,895 (resulting in total penalties of £44,391), but this was based on an incorrect calculation of tax of £93,986 for that year. HMRC have invited us to increase the penalty determination for 2006/07 to £33,580 so that the penalty is 35% of the actual tax.

3.

There is no dispute that the returns were incorrect or about the additional tax payable. The sole dispute is over the penalties. The appellant's case is that he was neither fraudulent nor negligent. If, contrary to his primary argument, the Tribunal were to find that he had been negligent then the penalties should be abated either in full or reduced to a maximum of 5%.

The evidence

4.

We heard oral evidence and received witness statements from the appellant and two other witnesses, Lorraine Shanks for HMRC and John Cassidy for the appellant. Miss Shanks is an HMRC officer in its Fraud Investigation Service and was responsible for the investigation into the appellant's affairs. Mr Cassidy is a tax partner at Crowe Clark Whitehill LLP and advised the appellant in relation to the investigation. Neither Mr Cassidy nor his firm acted for the appellant before the investigation commenced.

5.

Miss Shanks' evidence described the background to and conduct of the investigation. Among the attachments were detailed notes of a meeting she had with the appellant and Mr Cassidy on 30 October 2013. Mr Cassidy's evidence explained his involvement and also covered the conduct of the investigation, including the same meeting. To the extent that Miss Shanks' and Mr Cassidy's evidence comprised fact rather than opinion we accept it, save in relation to a dispute over what was said at the meeting which is dealt with below. Our conclusions on the appellant's evidence are also set out below, so far as relevant to our decision.

The capital loss claim: the "Pendulum Long" scheme

6.

Although the unavailability of the capital loss claimed by the appellant is not in dispute it is necessary to set out briefly what the scheme involved and the possible reasons why it failed.

7.

The scheme involved the purchase by the appellant of a contract for difference ("CFD") from Pendulum Investment Corporation ("Pendulum"), a company based in the Seychelles. The CFD had a maximum life of ten years from the start date and was linked to the FTSE 100 index. It was split into four phases with different target index levels at the ends of years 3, 5, 7 and 10. These levels were 9,690, 12,160, 14,180 and 16,890 respectively. If the relevant target index level was met Pendulum would pay out a specified percentage of the issue value, ranging from 150% at year 3 to 550% at year 10. The start date was 13 February 2007.

8.

An initial margin of 6% was payable. This was £51,000, which the appellant was required to invest from his own funds. The total issue value was £850,000. The balance of £799,000 (referred to as the "margin balance") was payable within 14 business days of the start date. This amount was to be funded by a loan from an Isle of Man company associated with Pendulum, Bayridge Investments LLC ("Bayridge"). The loan was interest free and for a period of 80 years. However, fees were payable to Bayridge if a profit was made from the CFD, and the loan also had to be repaid if fees were due. The fees were calculated as a percentage of the profit, being 30% for the first 3 years, 50% for the following 4 years and 75% after 7 years.

9.

The terms of the CFD also permitted the appellant to require Pendulum to make a written offer to repurchase all or part of the CFD at any time. The appellant exercised this right before the end of the tax year and disposed of 65% of the CFD, for which he received £11,000.

10.

It is relevant to HMRC's case that the documentation for the scheme included completion of a sophisticated investor statement for the purposes of the Financial Services and Markets Act 2000, under which the appellant declared that he was a sophisticated investor in relation to contracts for difference.

11.

The idea behind the arrangement was that for CGT purposes the entire £850,000 issue value would be available as base cost, but the loan would have a low present value because unless the FTSE reached certain (significant) levels the loan would only be repayable in 80 years time. The part disposal of the CFD was claimed to give rise to a loss of £539,000, being the difference between the £11,000 received and £550,000, which is in the region of 65% of £850,000 (the reason for it being slightly different was not explained).

12.

Counsel for the appellant put forward three potential reasons why the scheme failed. Mr Bracegirdle for HMRC did not suggest alternative arguments. The three reasons suggested were:

(1) Most obviously, that the loss was disallowed under s 16A Taxation of Chargeable Gains Act 1992 ("TCGA"). Section 16A was introduced by Finance Act 2007 but with effect from 6 December 2006. It prevents capital losses from being allowable where they accrue directly or indirectly in consequence of or in connection with arrangements which have a main purpose of securing a tax advantage. We agree that s 16A appears to be straightforwardly in point.

(2) That, applying purposive construction to s 38 TCGA, which governs allowable expenditure for CGT purposes, and on a realistic view of the facts (and bearing in mind that Bayridge was associated with Pendulum), the appellant did not in fact incur expenditure of £850,000 but instead a much lower amount, taking account of the £51,000 spent from his own resources and the present value of the obligation to repay the interest free loan in 80 years

(with the chances of the FTSE index reaching any of the relevant levels presumably being disregarded as commercially irrelevant contingencies). Counsel estimated this value to be around £16,000 using a 5% discounting rate. (We note that this approach might have given rise to some element of loss if both that amount and the £51,000 were treated as allowable expenditure in respect of the CFD, but that it is also possible that part of the expenditure might be recharacterised as fees for the scheme, so reducing or eliminating any loss.)

(3) That the arrangements were a sham within the principles set out in *Snook v West Riding Investments Ltd* [1967] 2 QB 786 and *Hitch v Stone* [2001] STC 214 (recently discussed in *Hamilton v Hamilton* [2016] EWHC 1132), meaning that documents were executed to give the appearance of creating particular legal rights and obligations in circumstances where there was a common intention that those rights and obligations should not actually be created. However, as we will return to later Mr Bracegirdle specifically confirmed that HMRC was not seeking to argue that the arrangements were a sham.

Findings of fact

Background and outline of events

13.

The appellant's original career was as a teacher. He started a property business in the early 1990s, purchasing residential properties, refurbishing them and letting them to students. He left the teaching profession in 1996 to concentrate on the business. He clearly had some success, and wrote a book about building a property portfolio which was published in 2006. On some occasions he took out loans to finance the business, secured by mortgages. He had no experience of the stock market and accepted in evidence that he did not know what a CFD was.

14.

Soon after starting his business the appellant attended a tax seminar for property landlords given by Lekh Mall, a chartered accountant at a firm called Appleby Mall. As a result of the seminar Mr Mall was instructed to handle the appellant's tax affairs. This was in 1993 or 1994. We accept the appellant's evidence that he knew little about tax at that time, having always been taxed through payroll as an employee. We also accept that he trusted and relied on Mr Mall, who was also a property landlord so that the appellant felt that there was a common interest. Mr Mall continued to deal with all of the appellant's tax affairs until July 2013. Prior to that point the appellant had experienced only one difficulty with Mr Mall. This related to advice he gave that the appellant did not need to keep receipts for small amounts of petty cash expenditure in his property business. This turned out to be incorrect and the appellant had to pay additional tax. Mr Mall had apologised for this and the appellant had put it behind him, other than reflecting the need to keep such receipts (and the need to get a good accountant) in his book.

15.

The appellant disposed of his property portfolio over three tax years, 2005/06, 2006/07 and 2007/08. For the first year capital gains tax ("CGT") was paid in the usual way on the gains arising. However, at a meeting on 8 December 2006 Mr Mall suggested that the appellant did not need to pay CGT on his property sales. Mr Mall explained that there was a "tax loophole" under which a loss could be created to offset the gains. We accept the appellant's evidence that he understood this to mean a flaw in the tax rules that allowed less tax

to be paid, and that he was assured that the arrangement was legal.

16.

The appellant accepted Mr Mall's suggestion of a meeting with Montpelier Tax Consultants ("Montpelier"), the group promoting the scheme, and this was arranged for 15 January 2007. Prior to the meeting there was further correspondence with Mr Mall, whom the appellant asked to compute his CGT liability for both 2006/07 and 2007/08. In the event these computations went through various iterations and ultimately turned out to have over-estimated the sale proceeds received for the properties sold in 2007/08.

17.

Two representatives of Montpelier presented the scheme at the 15 January meeting. The appellant was told that the scheme had had Counsel's backing, although no Counsel's opinion is among the papers available and the appellant could not recall whether he had seen it. Mr Mall was present at this meeting and at all the appellant's other meetings with Montpelier, and had discussions with the appellant before and afterwards. One of the documents produced at the meeting was a Montpelier memorandum dated 24 February 2006 which purported to set out "Taxation Considerations" in respect of an "Investment Opportunity in Long term FTSE Contracts". This outlined the structure with illustrative numbers, including key terms of the loan that an "associated company of Pendulum" was prepared to make. It described what it meant by "long term" as 5 to 15 years. It included the following statement:

> "Our opinion is predicated on the assumption that the investor seeks a FTSE exposure (long or short) at a small initial financial cost and that the tax consequences are a product of the contract acquired rather than the objective."

18.

The note goes on to describe the "taxation anomaly", which it said arose when the investor disposed of all or part of the contract when it had a market value below its cost, and gave an example of the loss that could arise which it attributed to the availability of the loan and the fact that it remained outstanding. It described the loss as a "by product of the overriding investment decision" to seek a position in the UK Stock Market.

19.

The subject of the sophisticated investor declaration also came up at the meeting. The appellant was assured that this was a formality and Mr Mall told the Montpelier representatives that the appellant was qualified to make the declaration because of his experience in property.

20.

After the meeting the appellant had further correspondence and discussions with Mr Mall. This included discussion of fees, further details about how the scheme worked and his CGT position. The appellant indicated that he was very concerned that the scheme was new and untested and that he risked losing money if it was successfully challenged. He also asked Mr Mall whether he had complete confidence in the scheme, whether he had dealt with Montpelier before and what their track record was. Mr Mall confirmed by

email that there could not be a 100% guarantee of success, but that whilst fairly new the scheme had been used previously. He said that "we" (presumably Appleby Mall) had dealt with Montpelier before and (whilst noting that past records were just that) everything they had done or were doing had been successful. He indicated that his firm were currently looking to shelter £4m of profits with Montpelier for another client. The same email from Mr Mall also said that the question he would pose is whether he would carry out the investment if he was in the appellant's position, and confirmed that he would on the basis that "all strategies that clients have used from this company and others have been successful", and because the scheme offered inheritance tax as well as CGT savings.

21.

The appellant also had email correspondence with his wife (from whom he was separated) about the "investment". The appellant's wife worked at a hedge fund. In the event she also entered into the scheme. The appellant asked his wife to talk to her colleagues about the scheme. The correspondence indicates that the colleagues were assumed by the appellant to be lawyers. At one point in the exchange the appellant's wife asked whether he had looked into getting supplementary advice from a registered financial adviser. His response was to the effect that he was too busy and that he was relying on her as his financial adviser to "get it right". It is also clear from the correspondence and his evidence that the appellant understood that an HMRC enquiry was likely.

22.

A second meeting was held with the same Montpelier representatives on 29 January, at which the appellant was told he needed to invest £51,000 and would receive back £17,000 on partial surrender of the investment.

23.

At a third meeting with one of the Montpelier representatives (Jane Goodall) on 7 February the appellant formally agreed to go ahead and was given documents for both him and his wife to sign. He signed some at the meeting and others at his home either later that day or at some point in the period up to 12 February. The documents were posted to Montpelier. The appellant accepted that he did not read much of the detail in the documents, and his focus had been on what he had to pay.

24.

The structure of the documentation involved, in outline, an application by the appellant for a so-called "Pendulum CFD passport", an offer by the appellant to enter into a CFD on the specified terms (both signed and dated 7 February), a master agreement (signed but not dated on the version we saw), and an acceptance by Pendulum of the appellant's offer, which had a printed date of 12 February. There were also documents confirming receipt of the initial margin and confirming to the appellant "that you have in fact satisfied your obligation to make payment of the Margin Balance".

25.

An administrative assistant at Montpelier sent the appellant forms for the transfer of the £51,000. On 13 February the appellant noticed an error in the issue value (it showed £850,000 in figures but six hundred thousand in words), which he asked to be corrected. The appellant's bank statement shows a payment to

Pendulum on 14 February. Having made the payment the appellant heard nothing back, which caused him some concern. He contacted the assistant again in mid March seeking reassurance that everything would be concluded by the end of the tax year, and was concerned to find that the assistant did not know and seemed to have little experience, and that the appellant's other contacts at Montpelier appeared to be on holiday. After some chasing Jane Goodall got back to him on 28 March with (the appellant thought) documents for a partial surrender. The appellant's evidence was that he signed and returned these despite some concerns about the dates, which the appellant thought had been left blank (see [30] below for our findings on this). The appellant received back £11,000, rather than the £17,000 he had expected, by bank transfer from Montpelier in May 2007. (The explanation for the difference may be that at the point of repurchase the whole CFD was valued by Pendulum at £17,000, whereas the repurchase related to 65% of it.)

26.

It is clear from further email correspondence between the appellant and his wife on 22 May 2007 that the failure to hear from Montpelier, the shortfall in the repayment and the administrative issues he had noticed made him concerned about Montpelier and the arrangements. Fraud is mentioned and at one stage he raised with Jane Goodall the possibility of going to the police. One email from the appellant says that he "can't blame Lekh" because he had had "no involvement other than to introduce them and attend the first meeting", that the appellant had not been "telling him about all the errors" but that he "should be there at the show-down". (In fact Mr Mall did attend all the meetings with Montpelier.) We accept that these concerns related to whether Montpelier had taken the appellant's money under false pretences rather than whether the scheme would be fraudulent in a tax sense if it was implemented.

27.

A final meeting was held with Montpelier on 24 May. At this meeting the appellant received assurances that the scheme had been fully implemented before the end of the tax year and that the loss could be used to offset his CGT liability. The appellant received an apology for the administrative problems. It was also agreed that Mr Mall rather than the appellant would handle all further contact with Montpelier and any enquiry from HMRC in relation to the scheme would be dealt with by Mr Mall.

28.

Mr Mall or his firm received commission from Montpelier for promoting the scheme. It is clear that this was not disclosed to the appellant at the time of the events we are considering.

Problems with the documents: the loan and repurchase

29.

There were two specific issues with the documents. The first related to the loan agreement. HMRC challenged the date on which the appellant entered into the loan, and also pointed out that the appellant had signed in the wrong place (he had signed in the space left for a Bayridge director to sign). The latter was clearly an error. As to the date, although the document has a printed date at the top of 12 February 2007 the dates are left blank on the signature pages. Jane Goodall also sent an email to the appellant on 28 March in connection with the partial disposal which said that she was "attaching loan documentation for the balance of the funds" and asking the appellant and his wife to sign a copy, leave it undated and send it back. There is no evidence of what was actually attached to the email (which may or may not have comprised or included loan documentation) and we accept the appellant's evidence that he did in fact sign loan documentation with

the other documents between 7 and 12 February.

30.

There were also some other problems with the repurchase documentation. The same email from Jane Goodall dated 28 March said that Pendulum was in receipt of the "instruction to partially surrender". However, the signed document under which the appellant required Pendulum to make an offer to repurchase had printed date of 4 April and a fax machine date on it of 5 April, Pendulum's offer to repurchase (acknowledging a "previous request") had a printed date of 30 March and was stated to be open for two business days, and the letter signed by the appellant accepting Pendulum's offer as to 65% of the CFD had a printed date of 4 April. The most likely explanations are either that the 30 March date was wrong or that there is missing documentation (the appellant gave evidence that he had lost a substantial number of emails on transferring to a new computer). However, the overall effect is tolerably clear and, more significantly, HMRC did not argue either that no repurchase had occurred, or that it had not occurred before the end of the 2006/07 tax year.

The appellant's 2006/07 return and HMRC's enquiry

31.

The appellant's tax return for 2006/07 was prepared by Mr Mall and filed electronically. The CGT pages of the return show at page CG2 disposal proceeds of £11,000 and losses arising of £539,000 on "Part Disposal of Long Position FTSE CFD". In the "Other shares or securities-further information" section at page CG4, in a section requesting a "description of shares or securities" the following description was included:

> "550,000.0000 shares were sold in Part Disposal of Long Position FTSE CFD. See page CG2 row 3. Asset description: Part Disposal of Long Position FTSE CFD."

32.

We note that during the enquiry and when preparing her witness statement Miss Shanks must for some reason have been viewing an incomplete version of this text on HMRC's systems. That version ended with the word "See" and was relied on as being clearly incomplete. No explanation was provided of this by HMRC at the hearing. Mr Bracegirdle instead relied on the use of the word "shares" to say that the description was misleading. Whilst we agree that they were not shares in a conventional sense it is clear from the overall description what the asset was. We also note that the relevant headings in the form rather invite use of the term "shares". The printed instructions above the entry not only require a "description of shares or securities" but refer to the need if possible to "give a history of the shares disposed of".

33.

HMRC had become aware of loss relief claims involving Pendulum and set up a team to investigate them. The description on the appellant's return "Part Disposal of Long Position FTSE CFD" was sufficient to trigger an enquiry in January 2009. The appellant was notified of the enquiry but the detailed questions were addressed to Appleby Mall. Mr Mall dealt with all the correspondence, doubtless with significant input from Montpelier. The appellant's evidence was that he had no involvement in the correspondence and did not see it. We accept this evidence, which we do not consider was successfully challenged in cross-examination. In our view the content of the correspondence is therefore not particularly material, but we have included a description of points that were relied on by HMRC in preparing their case, not least because we think it gives

context to HMRC's suspicion that fraud was involved.

34.

In his first substantive reply by letter dated 18 March 2009 Mr Mall answered a number of questions about the transaction and also made two other points that are worth setting out in full. First, in answer to a request for an explanation of why the appellant was able to make a sophisticated investor statement in relation to CFDs Mr Mall said that it was because of his "investment experience built up over a considerable period of time" which "helped provide him with the knowledge to understand and assess higher risk investments such as CFDs and, in particular, the CFD contract offered by Pendulum".

35.

Secondly, in answer to a question about the disclosure regime in Part 7 Finance Act 2004, the letter says:

> "We do not consider the disclosure regulation in Part 7 Finance Act 2004 as amended by s 108 Finance Act 2007, to be an issue. Our client has taken out a CFD contract giving him as the investor an exposure to the FTSE over a 10 year period achieving his financial aims and it seems clear that in commercial terms Pendulum believes that it will retain the value of the contract (less any encashment value) as profit with cashflow advantages therefrom while believing that the FTSE indices over the CFD contract period will not be met (or at least hedged against). The contract, therefore, is commercial to both the investor and the issuer.
>
> Our client has the right to dispose of the contract in full or in part but the disposal value is based on market forces at the time. The capital loss that has arisen by the part disposal of the contract is a by-product of the overriding investment decision by our client to seek a long term position in the UK Stock market by means of a contract based on the FTSE Index with a view to capital appreciation."

36.

HMRC subsequently asked additional questions, including about the potential application of s 16A TCGA. A further letter from Mr Mall dated 30 June 2009 responds that it was not thought to apply and states:

> "We do not believe an arrangement exists of which one of the main purposes is to secure a tax advantage. Our client has acquired a CFD contract as an attractive investment opportunity in the form of a long- term exposure to the UK Stock Market and this was made more attractive by the financing arrangements entered into with Bayridge Investments LLC. As any investor is aware the Stock Market conditions can fluctuate and it is appropriate that the contract enables our client to dispose of the contract in full or part at any time he considers appropriate."

37.

In December 2010 the appellant was informed by HMRC that a criminal investigation was being conducted into the activities of the Montpelier companies and the CFD scheme. We accept the appellant's evidence that he was alarmed by this but not overly concerned because the letter indicated that civil enquiries would continue as far as the appellant was concerned.

38.

The appellant heard nothing more until 2012 when he learnt that Montpelier had been raided. He sought further advice from Mr Mall, who up until this point had responded to his questions about how the enquiry

was going to the effect that such matters always took a long time. On this occasion Mr Mall still advised that the scheme should work but suggested that the appellant might wish to purchase a tax certificate to prevent continued exposure to interest. Mr Mall also wrote to HMRC to enquire about progress on 17 October 2012, clearly prompted by the appellant's approach to him. The appellant bought a tax certificate for £150,000 in December 2012, reflecting the disputed tax and around £21,000 of interest.

39.

Miss Shanks became involved when she was asked to review the case for a possible "COP 9" investigation in April 2013. COP 9 refers to HMRC's Code of Practice 9 procedure, which governs civil investigations where fraud is suspected. Miss Shanks concluded that there was sufficient evidence to indicate tax fraud. This was based on Appleby Mall's contention in their letter dated 30 June 2009 that s 16A TCGA was not in point. Miss Shanks' witness statement also indicated that her decision was based on the date of the loan agreement, which she thought post-dated the period during which the loan was required to fund the transaction under the CFD terms, but Miss Shanks corrected this at the hearing by explaining that that point only came to light in July 2014.

40.

In July 2013 Miss Shanks wrote to the appellant explaining that he was suspected of committing tax fraud and inviting full disclosure under the COP 9 procedure (under which, in return for full disclosure of any fraud, HMRC undertake not to prosecute). We accept the appellant's evidence that he was shocked by this. He also immediately followed the recommendation in the COP 9 literature to appoint an adviser with experience in COP 9 investigations, by appointing Crowe Clark Whitehill LLP. Mr Cassidy responded to Miss Shanks' letter on 29 July 2013 with a denial of fraud and providing additional background information about the appellant and his involvement in the scheme.

41.

The appellant, Mr Cassidy and one of Mr Cassidy's colleagues met with Miss Shanks and another HMRC officer on 30 October 2013. This was the only meeting during the enquiry. Miss Shanks' detailed meeting notes, which are not limited to the Pendulum scheme and cover the appellant's affairs more generally, ran to over 20 pages, and were dictated from handwritten notes and from memory over the two days immediately following the meeting.

42.

Subject to one point the notes of what the appellant said at the meeting about the scheme and his involvement in it are substantially consistent with the appellant's own evidence. This included assurances received that the scheme was legal, the advice and assurances from Mr Mall that Montpelier's schemes were successful and he would implement the scheme in the appellant's position, the understanding that the scheme had been blessed by Counsel, the fact that he took advice from his ex-wife and colleagues of hers, that he knew little about tax and relied on Mr Mall, and that he had concerns about Montpelier which led to a threat to contact the police but that he was reassured at a subsequent meeting. The appellant also confirmed that he knew from the outset that it was a tax avoidance scheme and that he disagreed with Mr Mall's statement to the contrary in his letter of 30 June 2009, an extract of which Miss Shanks read to him. He expected a loss rather than a profit. He clearly showed no knowledge of s 16A TCGA.

43.

The one material point of contention at the hearing about Miss Shanks' notes related to what the notes said about the appellant's knowledge of the loan from Bayridge. Miss Shanks' notes state that the appellant had no idea who Bayridge was and said that he was not aware he had a loan from Bayridge. Miss Shanks maintained in her witness statement and at the hearing that, based on her contemporaneous notes, the appellant had said that he had no knowledge that a loan existed. Both Mr Cassidy's evidence and that of the appellant conflicted with this. Mr Cassidy said that the appellant had not said that he knew nothing about a loan: he knew it existed but did not know about the nuts and bolts of it. Mr Cassidy included a comment to this effect in a letter to Miss Shanks dated 19 December 2013 and it is also included in some undated notes described as "Thoughts on HMRC's minutes". The appellant's evidence was consistent with Mr Cassidy's and the appellant was also clear that his view was that the value of an 80 year interest free loan was "negligible" due to the effect of inflation, such that no money needed to be put aside for it.

44.

Overall we prefer Mr Cassidy's and the appellant's evidence on this point. Miss Shanks did not appear to be relying on any recollection independent of her notes. Those notes are also somewhat ambiguous and can be read consistently with the appellant saying that he did not know he had a loan *from Bayridge* rather than not knowing he had a loan at all. The appellant was also very clear in his oral evidence that he was aware of the loan, and had signed it with the other papers he was given to sign between 7 and 12 February 2007. In our view HMRC did not successfully challenge this evidence.

45.

It was made clear at the meeting and in the correspondence that followed that the appellant would not agree to settle the case on the basis of fraudulent behaviour. Offers were made on his behalf to withdraw the loss claim in both November and December 2013, and in April 2014 (whilst not admitting negligence) an offer was made on a without prejudice basis to pay a 5% penalty on the basis of negligent behaviour. None of the offers were accepted but the appellant did in fact withdraw his loss claim in October 2014.

46.

Penalties were subsequently determined at 35% of the tax at stake. This was on the basis of fraudulent behaviour, although HMRC's position in correspondence and before the Tribunal was that the percentage should be the same whether the behaviour was fraudulent or negligent. To arrive at the 35% HMRC applied their practice of considering disclosure, co-operation and seriousness. They allowed an abatement of 15% for disclosure (out of a maximum under the HMRC practice of 20% or exceptionally 30%), 35% (out of a maximum of 40%) for co-operation and 15% (out of a maximum of 40%) for seriousness.

The law

Section 95 TMA

47.

At the relevant time s 95 TMA provided as follows:

> "(1) Where a person fraudulently or negligently--

(a) delivers any incorrect return of a kind mentioned in section 8 or 8A of this Act (or either of those sections as extended by section 12 of this Act)...

he shall be liable to a penalty not exceeding the amount of the difference specified in subsection (2) below.

(2) The difference is that between--

(a) the amount of income tax and capital gains tax payable for the relevant years of assessment by the said person (including any amount of income tax deducted at source and not repayable), and

(b) the amount which would have been the amount so payable if the return... as made or submitted by him had been correct.

(3) The relevant years of assessment for the purposes of this section are, in relation to anything delivered, made or submitted in any year of assessment, that, the next following, and any preceding year of assessment."

48.

Section 97 TMA provided that if a return was made by a person not fraudulently or negligently but it came to his notice that it was incorrect, then unless remedied without unreasonable delay, the return should be treated as having been made negligently. HMRC did not seek to rely on this provision.

49.

Both parties accepted that the burden of proof is on HMRC to show (on the balance of probability) that the appellant acted fraudulently or negligently: *King v Walden* 74 TC45 and *HMRC v Khawaja* [2008] EWHC 1867. There was also no dispute that HMRC needed to show that the appellant himself, not an adviser, was fraudulent or negligent.

50.

It was not entirely clear to us whether HMRC's position was that the alleged fraudulent or negligent act related solely to the delivery of the 2006/07 return, or whether HMRC's case was that both that return and the 2007/08 return were delivered fraudulently or negligently. The relevant penalty determination appears to have been issued on the latter basis but both HMRC's statement of case and the arguments before us proceeded on the former basis. In fact we doubt that the distinction would make any real difference on the evidence before us in this case. No evidence was produced to show that anything material occurred between the date of submission of the two returns which would have affected the appellant's state of knowledge or culpability (we were not provided with the date of the appellant's 2007/08 return so are unable to determine whether it was filed after commencement of the enquiry into the 2006/07 return, which might have been relevant to the position for 2007/08). And as a matter of law we consider that the penalties could have been determined on either basis. If, as the case was argued before us, the alleged behaviour related solely to the 2006/07 return then it is clear from s 95(2) and (3) that the penalty can be determined for more than one year of assessment, being the year in which the return is delivered, the next following and any preceding year. We have assumed (in the absence of evidence to the contrary) that the 2006/07 return was delivered in the 2007/08 year, so both it and 2006/07 (as a preceding year) are relevant years of assessment. If in contrast the two years are considered separately then HMRC would need to show that the fraudulent or negligent behaviour for 2007/08 consisted of the inclusion of brought forward capital losses to offset gains shown in the return. However, since they did not in fact argue their case on that basis we have taken the approach

adopted by both parties at the hearing and considered the behaviour of the appellant only at the time that the 2006/07 return was submitted.

51.

Counsel for the appellant submitted that, in determining whether s 95 applies, it is necessary to (a) conclude that the appellant's conduct up to the point of filing of the return, rather than subsequent conduct, was fraudulent or negligent (in contrast to s 97 TMA) and (b) find that there is a causal nexus between the alleged fraudulent or negligent conduct and the incorrect tax position stated in the return. Mr Bracegirdle for HMRC did not seek to dispute these submissions.

52.

We agree with Counsel for the appellant that the question is whether *the return* was delivered fraudulently or negligently. Subsequent conduct is relevant only insofar as it provides evidence of whether that earlier conduct was indeed fraudulent or negligent, and of course (as Counsel accepted) in determining the appropriate level of any penalty that is found to be due. We also agree that an element of causation is required. The error in the return must be attributable to the fraud or negligence of the appellant. This follows straightforwardly from the wording of s 95(1) and is supported both by the obvious policy objective and by the method of calculating the penalty under s 95(2), by reference to the additional tax payable if the return had been correct.

Fraud or negligence

53.

An allegation of fraud is a serious one. Mr Bracegirdle for HMRC relied on the classic description of fraud by Lord Herschell in *Derry v Peek* (1889) LR 14 App Cas 337, where he referred to fraud being proved where it is shown that a false representation was made "(1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false". In fact Lord Herschell went on in the same paragraph to explain that categories (2) and (3) were not really distinct, because in the latter case there can be no real belief in the truth of what was stated. Lord Herschell summarised the position by saying that to prevent a false statement being fraudulent that must be "an honest belief in its truth".

54.

Mr Sykes for the appellant suggested that the focus should be on dishonesty, and referred to *Stuttard and another (trading as de Wynns Coffee House) v Customs and Excise Commissioners* [2000] STC 342, where it was held that recklessness was not dishonesty but might be evidence of it. We note that this is a case on VAT civil evasion penalties, and that there have been a number of other more recent cases that consider the concept of "dishonesty" in that and other civil contexts (see for example *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, *Barlow Clowes International Ltd v Eurotrust International Ltd* [2006] 1 WLR 1476 and *Abou-Ramah v Abacha* [2006] EWCA Civ 1492, considered in a VAT context in a number of First-tier Tribunal cases including *Bintu Binette Krubally N'Diaye v HMRC* [2015] UKFTT 380 (TC)). We did not find these cases to be of material assistance in the context of s 95 TMA and the test for fraudulent completion of a tax return.

55.

Although not directly relevant we note that the statutory criminal offence of fraud in the Fraud Act 2006 includes as part of the definition of fraud by false representation a requirement both for dishonesty and that the person in question knows that the statement is or might be untrue or misleading. This part of the test has strong similarities to Lord Herschell's description.

56.

For present purposes we see no reason not to apply the test set out by Lord Herschell, namely that the key question is whether the appellant had an honest belief in the correctness of the return. In order to prove fraud HMRC must prove that he did not.

57.

As to negligence, HMRC referred to the definition provided by Alderson B in *Blyth v Birmingham Waterworks Co* [1856] 20 JP 247, namely "the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do". In *Anderson v HMRC* [2009] UKFTT 258 at [22] (cited with approval by the Upper Tribunal in *Colin Moore v HMRC* [2011] UKUT 239 (TCC) at [8]), Judge Berner said that the test for negligence is to "consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done".

58.

HMRC also relied on *Litman & Newall v HMRC* [2014] UKFTT 089 (TC). In that case, which also related to a Montpelier scheme involving a loan, the appellants were found to be negligent because they failed to enquire into the "basic commercial reality" of the scheme. Judge Short went on at [47] to say that a reasonable taxpayer:

> "...would have ensured that the commercial elements of the transaction, including the loan in particular, stood up to some commercial scrutiny and had been properly implemented."

59.

Mr Sykes argued that there may be a range of responses to any scenario by a reasonable person, and that HMRC needed to show that no reasonable person would have acted in the relevant way, referring by analogy to *Barker v Baxendale Walker* [2016] EWHC 664 at [126] to [128] (a case on solicitors' duties). He also referred to *Gedir v HMRC* [2016] UKFTT 188 (TC), which considered the test to apply where a taxpayer relies on an agent to complete his return. Following the earlier case of *Hanson v HMRC* [2012] UKFTT 314, the Tribunal found that reasonable care is taken where the adviser consulted is reasonably believed to be competent and is provided with the relevant information, the adviser's work is checked to the extent possible, and the advice is implemented (see [115]). This did not mean that the taxpayer should be expected to identify an error in respect of complex legal points, as opposed to a case where there was an obvious error or the position being taken was obviously untenable.

60.

We agree with the comments in *Gedir* and *Hanson*. We do not think it necessary to decide whether the

analogy with *Barker v Baxendale Walker* is appropriate (the context is very different) and agree with HMRC that the correct test is that set out in *Blyth* and *Anderson*. We comment further below on *Litman*.

Discussion

Fraud

61.

Mr Bracegirdle relied on a number of points which in HMRC's view demonstrated fraud:

(1) The tax return described the asset as "shares", which it was not. We have already dealt with this point. It is clear from the complete description what the asset was. We neither think the reference particularly misleading nor consider that it provides any indication of fraud on the part of the appellant. We also note that, even at the time HMRC's skeleton argument was prepared they were still under the impression that the asset description which included a reference to "shares" was incomplete on the return, which it was not. To the extent that this contributed to HMRC's approach to the case it is regrettable, and the error should have been acknowledged.

(2) The appellant signed a document confirming that he was a sophisticated investor, whereas he told Crowe Clark Whitehill LLP that he was not: he had never bought any shares and knew nothing about the (stock) markets, and had made his money in property. This was presumably relied upon as an indicator that the appellant was prepared to sign a document that he knew was not true. However, we accept the appellant's explanation that he relied on assurances that this document was a formality and on Mr Mall's confirmation to Montpelier that the appellant was qualified to sign it.

(3) The appellant claimed a loss of £539,000 when he knew that he had not made an economic loss of that amount. We cannot accept this as an indicator of fraud. The tax system is highly complex and there are many instances where the calculation of a profit or loss for tax purposes differs markedly from the economic profit or loss. In some cases the fisc benefits from the difference and in other cases it does not. What matters is the appellant's state of mind: did he have an honest belief that the contents of the return were correct? A substantial difference between an economic profit or loss and the amount suggested to be the profit or loss for tax purposes might readily be said to prompt the reasonable man to ask his adviser some questions to confirm the position, but we cannot see that it is an indicator of fraud.

(4) HMRC referred to evidence that they had received of an internal email exchange at Montpelier in 2005 which suggested (in relation to an unidentified scheme that involved a 50 year loan) that the loan "in reality won't be called", but there was "nothing to say that in any paper work" and investors must be "seen to pay the full price for the cfd". We do not think that these exchanges help demonstrate fraud on the part of the appellant. The appellant was not involved in them and we have accepted that he understood that there was a loan but that the present value of the liability was low (a point confirmed, incidentally, in the same internal email exchange). We do not accept HMRC's proposition that the exchange indicated that the appellant would have been reassured by the Montpelier representatives who presented the scheme that no debt would be created- a proposition which HMRC also failed to put to the appellant in cross examination. HMRC's submission also strays into the territory of an argument that the transaction was a sham, which Mr Bracegirdle specifically reconfirmed in this context that HMRC was not alleging. We think it follows from this that the loan must be respected.

(5) A related point is that HMRC questioned whether the loan had in fact been entered into in time for the transaction to be implemented, and also questioned the time line for repurchase of the CFD, which as discussed above does not make sense based on the printed dates on the documents. The fact that the repurchase could not have followed the timeline represented in the documents meant, HMRC said, that the appellant knowingly misrepresented a key sequence of events which was a crucial part of the scheme. We do not agree. We have accepted the appellant's evidence that he entered into the loan on or before 12 February. We agree that the paperwork for the repurchase was confused and that the dates stated cannot be entirely correct, but sense can be made of them and HMRC are not alleging sham. The appellant was also aware that there had been problems with the paperwork. Importantly however he was reassured by both Mr Mall and Montpelier in the final meeting in May 2007 that the scheme had been implemented and the loss was available.

(6) Finally, HMRC argued that the appellant was advised by his advisers to misrepresent the scheme. We cannot accept this allegation, which was also not clearly put to the appellant in cross examination and is inconsistent with the facts we have found.

62.

At the hearing, and having cross examined the appellant, HMRC did not pursue an argument that the appellant was a party to Mr Mall's responses during the enquiry about the disclosure regime and s 16A TCGA, which represented that the transaction was an investment opportunity rather than a tax scheme. We have found that the appellant was unaware of these responses until later in the enquiry. In any event those responses do not necessarily support an allegation of fraud in relation to the earlier submission of the return.

63.

In summary, we have concluded that none of the arguments put forward by HMRC to support its allegation of fraud can be sustained. HMRC has not shown that the appellant did not have an honest belief that his tax return was correct. On the contrary, we are persuaded that the appellant did believe that his tax return was correct.

Negligence

64.

HMRC relied on a number of the same points to support their argument that the appellant was, in the alternative, negligent. In particular:

(1) As in the *Litman* case the appellant should have considered the commercial reality. The transaction did not stand up to commercial scrutiny. The appellant's failure to check the commercial reality amounted to negligence.

(2) The appellant did not check that the dates on the repurchase documents made chronological sense.

(3) The terms of the CFD required the margin balance to be paid within 14 business days, but Jane Goodall asked the appellant to sign the loan agreement for the loan that would fund this only on 28 March 2007. The only available copy of the loan had an undated signature and was consistent with Ms Goodall's email of 28 March. HMRC submitted that the loan agreement was therefore signed only after the deadline for paying the margin balance had passed.

(4) The loan agreement was on terms that no commercial lender would offer, and the appellant has made no provision to repay it.

(5) The appellant accepted Pendulum's valuation of £17,000 for a CFD that he had purchased for £850,000 shortly before, and made no attempt to validate that.

(6) The appellant accepted that he had not kept copies of the documentation. A reasonable person would have done so.

(7) The appellant described the asset as "shares" on his tax return.

(8) The appellant relied on informal advice, including from Mr Mall, Montpelier representatives, his wife and her colleagues. This was a complex financial transaction and the appellant should have obtained proper independent financial advice.

65.

We have already addressed points (3) and (7). In relation to the other points we should make it clear that we agree with HMRC that some aspects of the appellant's behaviour could be described as careless. A reasonable man would have paid more attention to the documents and would have kept copies at least of key ones such as the loan. Given the significance of them he would probably also have gone some way to ensure that the dates on the repurchase documentation (which was in pretty short form and fairly straightforward) made basic chronological sense and that there were no other clear deficiencies. However, our task is not to decide whether the appellant was negligent in the abstract. The question is whether he negligently filed an incorrect return within s 95(1) TMA. So we need to focus on the error in the return and whether the appellant was negligent in making that error.

66.

On balance we have concluded that HMRC has not discharged its burden of proof to demonstrate that the appellant was negligent in filing an incorrect return. We are persuaded that the appellant relied fully on Mr Mall, a chartered accountant on whom he had relied for a number of years, and on what he believed (based on Mr Mall's recommendation) to be Montpelier's expertise. Faced with their assurances that the scheme was legal and based on a tax "anomaly" we do not think that the fact that the terms of the loan were uncommercial, or that the CFD transaction itself was clearly uncommercial, demonstrate negligence for s 95(1) TMA purposes. We also do not think that the appellant was negligent for s 95(1) purposes in failing to obtain independent financial advice. If he had that might well have reinforced the rather obvious point that the entire transaction was uncommercial (which we think was clear enough to the appellant in any event), but would not have informed the appellant about how to fill in his tax return.

67.

The *Litman* case discussed above can be distinguished. It is clear from the discussion in that case that there was no evidence that the loan was ever made or repaid. As described at [30] and [39] in the judgment HMRC's position was that the documentation did not demonstrate that the transactions had been carried out, and that a taxpayer who entered into a packaged tax scheme needed to establish that it was not a sham from a commercial perspective. This is picked up in the subsequent discussion, with findings at [43] and [44] that the Tribunal could not accept that it was reasonable for the taxpayers not to ascertain whether a loan was made, and it is also reflected in the comments at [47] referred to above, which go on to say that the taxpayers should not have claimed the losses without at least understanding that an actual transaction had been entered into. In contrast in this case HMRC has clearly confirmed that it is not relying on any argument that the transaction was a sham.

68.

We have given careful consideration to the fact that the appellant did have his own concerns about the implementation of the scheme, including errors made by Montpelier and the clear lack of experience of junior staff apparently left to handle it. In the absence of subsequent reassurances, completion of a tax return on the assumption that the scheme worked might well have amounted to negligent behaviour. However, in order for s 95 to be engaged HMRC would also have needed to show that there was a causal link between the negligence and the errors in the return. Given that HMRC has accepted that the transaction was not a sham this would not be a straightforward point: HMRC would probably need to pursue a line of argument that the errors should have been of sufficient concern to prompt the appellant to seek advice from another tax specialist before completing the return, which should (if the adviser had sufficient expertise) have led to the appellant being advised that the scheme did not work either due to the application of s 16A TCGA or for other reasons. However, HMRC put forward no such argument and it is not obvious to us that such an argument would have succeeded.

69.

More significantly, the appellant did in fact receive clear reassurances from Mr Mall and from Montpelier at the final meeting on 24 May 2007. We have concluded that these reassurances meant that the appellant's knowledge of problems with implementation does not assist HMRC.

Penalty mitigation

70.

Although it is not necessary to our decision we will comment on this aspect briefly since it was argued before us, and in case there is a further appeal.

71.

Both parties proceeded on the basis that we should apply HMRC's practice, described at [46] above. If this approach is adopted then we do think that some criticisms can validly be made of HMRC's application of that practice in this case. First, HMRC allowed a 15% rather than 20% reduction for disclosure and 35% rather than 40% for co-operation on the basis of Mr Mall's initial responses during the enquiry. HMRC accepted that once Mr Mall was no longer involved there was full co- operation and disclosure. Given our findings that the appellant was not aware of or involved in the content of Mr Mall's responses it does not seem appropriate to make any reduction based on them. Secondly, allowing a 15% rather than 40% reduction for seriousness on a basis which does not distinguish between fraud and negligence seems to us to be highly questionable.

Seriousness cannot just depend on the sums involved. Fraud is in a quite different category to negligence. The fact that both are referred to in s 95 makes no difference. We would fully expect the percentage to vary depending on whether fraud or negligence is established, reflecting the degree of culpability, and if the appellant had been found to be negligent for s 95 purposes we would have been inclined to reduce the penalty on that basis. Since we have not found that the appellant was negligent we do not think it appropriate to comment on the precise penalty percentage that would should apply if our conclusion was different, since that would clearly depend on the detailed findings.

Conclusion

72.

The appeal is allowed on the basis that HMRC has not demonstrated that the appellant acted fraudulently or negligently in delivering an incorrect return.

73.

This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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