Neutral Citation Number: [2019] EWCA Civ 747

Case No: C1/2018/1385

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT
Sir Ross Cranston
[2018] EWHC 1271 (Admin)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 01/05/2019

Before:

LORD JUSTICE GROSS
LORD JUSTICE NEWEY
and
SIR TIMOTHY LLOYD

- -

Between:

The Queen on the application of GEOFFREY RICHARD HAWORTH	**Appellant (Claimant)**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents (Defendants)**

- -
- -

Mr Giles Goodfellow QC and Mr Ben Elliott (instructed by **Levy & Levy**) for the **Appellant**
Mr Timothy Brennan QC and Mr Christopher Stone (instructed by **General Counsel and Solicitor to HM Revenue and Customs**) for the **Respondents**

Hearing dates: 2-3 April 2019

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Approved Judgment

Lord Justice Newey:

1. "Follower" and "accelerated payment" notices were introduced by the Finance Act 2014 ("FA 2014") with a view to addressing tax avoidance. A follower notice renders the recipient liable to a penalty if he does not take steps to counteract or surrender a tax advantage. An accelerated payment notice requires up-front payment of disputed tax.

2. This case concerns the validity of follower and accelerated payment notices which the respondents, HM Revenue and Customs ("HMRC"), gave to the appellant, Mr Geoffrey Haworth, in June 2016. Sir Ross Cranston dismissed a claim for judicial review of the notices, but Mr Haworth appeals against that decision.

Basic facts

3. At the beginning of 2000, a trust established by Mr Haworth for the benefit of himself and his family held shares in a company called TeleWare plc. A plan developed to merge TeleWare plc with another company, Workplace Systems Group Limited, and to list shares in the new company, in the event TeleWork Group plc ("TeleWork"), on the London Stock Exchange. Mr Haworth was advised that gains arising on the disposal of shares held by the trusts could avoid capital gains tax if the existing Jersey trustees resigned in favour of trustees resident in Mauritius, where there was no capital gains tax. In April 2000, Mr Haworth's tax adviser, Mr Christopher Maslen, reported to Pinsent Curtis, solicitors:

> "Counsel has suggested that trustees could be appointed resident in a jurisdiction which has a suitable double taxation treaty with the UK. This would be followed by a disposal. UK resident trustees would be appointed before the end of the tax year in which the disposal takes place. The gains arising in the hands of the intermediate trustees could escape taxation."

4. On 1 June 2000, Mr Maslen wrote to Mr Chandra Gujadhur of Deloitte & Touche Offshore Services Limited explaining that Mauritius trustees might be able to meet his client's tax planning needs. After the trustees were appointed, Mr Maslen said, they would be asked to undertake "various steps", including "the disposal of some trust shareholdings" and "the onward appointment of UK trustees, probably at the end of October 2000".

5. On 26 June 2000, the Jersey trustees formally retired in favour of Mr Gujadhur and Deloitte & Touche Offshore Services Limited. The trust became registered in Mauritius.

6. The group restructuring took place in early July 2000, as a result of which the Mauritian trustees became shareholders in TeleWork. On 3 August, TeleWork was floated and all the shares that the trust held in the company were sold in the course of the flotation.

7. In October 2000, the Mauritian trustees retired and United Kingdom trustees were appointed.

8. On 8 July 2010, the Court of Appeal, by a majority, ruled in favour of HMRC in *Smallwood v Revenue and Customs Commissioners* [2010] EWCA Civ 778, [2010] STC 2045. In that case, as in the present one, relief was claimed under the UK/Mauritius double tax agreement. Mr Smallwood had established a trust for the benefit of himself and his family which had a Jersey trustee. To avoid capital gains tax on a sale of shares held by the trust, a scheme was devised pursuant to which a Mauritian company became the trustee in December 2000, the shares were sold in January 2001 and Mr Smallwood and his wife, who were both resident in the United Kingdom, replaced the Mauritian trustee in March 2001.

9. Article 13(4) of the UK/Mauritius double taxation agreement provided for capital gains to be taxable "only in the Contracting State of which the alienor is a resident". It was argued by the Smallwoods that article 13(4) had to be read as fixing the date of disposal as the reference point for the determination of residence, but the Court of Appeal was unanimous in rejecting that submission and in concluding that article 4(3) of the double taxation agreement, under which the residence of a corporate entity resident in both Contracting States was deemed to be "the Contracting State in which its place of effective management is situated", had to be applied in relation to the period "up to and including the sale of the shares during which [the Mauritian trustee] remained the trustee" (see paragraph 47). There was unanimity, too, that the "place of effective management" (or "POEM") should be decided on the basis of the following passage from a commentary on article 4(3) of the OECD Model Convention on the double taxation of income and capital:

> "As a result of these considerations, the 'place of effective management' has been adopted as the preference criterion for persons other than individuals. The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

Patten LJ noted in paragraph 49 of his judgment that counsel for Mr and Mrs Smallwood "accepts that this is the test to be applied and that what has to be identified is the place where the real top-level management of the trustee qua trustee occurred rather than the day to day administration of the trust".

10. Where the members of the Court of Appeal parted company was on the application of the test. In this respect, Hughes LJ, with whom Ward LJ agreed, differed from Patten LJ. Hughes LJ said this:

> "[66] On the issue of POEM, with suitable hesitation, I respectfully differ from Patten LJ.

[67] The Special Commissioners' conclusion on the issue of POEM was one of fact. The taxpayers can succeed on their cross-appeal only if the Special Commissioners reached a conclusion of fact which was simply not available to them, and thus made an error of law: *Edwards (Inspector of Taxes) v Bairstow* (1955) 36 TC 207, [1956] AC 14.

[68] If the question were the POEM of the particular trust company trustee for the time being at the moment of disposal, namely PMIL, then it may be that the reasoning in *Wood v Holden (Inspector of Taxes)* [2006] STC 443, [2006] 1 WLR 1393 would justify the conclusion that the commissioners fell into this kind of error. I agree that their findings do not go so far as findings that the functions of PMIL were wholly usurped, and I agree that *Wood v Holden* reminds us that special vehicle companies (or, no doubt, special vehicle boards of trustees) which undertake very limited activities are not necessarily shorn of independent existence; indeed they would be ineffective for the purpose devised if they were.

[69] But it seems to me that to apply this reasoning to the present case is to ask the wrong question, and indeed to return to the rejected snapshot approach. The taxpayers with whom we are concerned under s 77 are the trustees. Trustees are, by s 69(1) TCGA 1992 [i.e. the Taxation of Chargeable Gains Act 1992], treated as a continuing body:

'In relation to settled property, the trustees of the settlement shall for the purposes of this Act be treated as being a single and continuing body of persons (distinct from the persons who may from time to time be the trustees), and that body shall be treated as being resident and ordinarily resident in the United Kingdom unless the general administration of the trusts is ordinarily carried on outside the United Kingdom and the trustees or a majority of them for the time being are not resident or not ordinarily resident in the United Kingdom.'

The POEM with which this case is concerned is, as it seems to me, the POEM *of the trust*, ie of the trustees as a continuing body. That is the question which the Special Commissioners addressed: see their paras 140 and 145.

[70] On the primary facts which the Special Commissioners found at paras 136–145, which are set out in the judgment of Patten LJ, I do not think that it is possible to say that they were not entitled to find that the POEM of the trust was in the United Kingdom in the fiscal year in question. The scheme was devised in the United Kingdom by Mr Smallwood on the advice of KPMG Bristol. The steps taken in the scheme were carefully orchestrated throughout from the United Kingdom, both by KPMG and by Quilter. And it was integral to the

> scheme that the trust should be exported to Mauritius for a brief temporary period only and then be returned, within the fiscal year, to the United Kingdom, which occurred. Mr Smallwood remained throughout in the UK. There was a scheme of management of this trust which went above and beyond the day to day management exercised by the trustees for the time being, and the control of it was located in the United Kingdom."

11. HMRC's position is that *Smallwood* and the present case are both examples of what tax practitioners know as the "Round the World" scheme. In *Lee and Bunter v Revenue and Customs Commissioners* [2017] UKFTT 279 (TC) Judge Bishopp, sitting in the FTT, said this about that scheme (at paragraph 19 of his decision):

> "The key to the success of the round the world scheme lies, first, in ensuring that the relevant trust is resident in an overseas territory with which the UK has a DTC [i.e. double tax convention] for part of the tax year, that the disposal takes place while it is so resident, and that it is resident in the UK for the remaining part of the tax year, thus engaging the DTC and overriding ss 77 and 86 [of the Taxation of Chargeable Gains Tax Act 1992], and, second, in the exploitation of the 'tie-breaker' of art 4(3) of the DTC in order to ensure that taxation rights are vested exclusively in the overseas territory."

12. As, however, was stressed by Mr Giles Goodfellow QC, who appeared with Mr Ben Elliott for Mr Haworth, the "Round the World" scheme is not a single, marketed scheme using standard-form paperwork. A member of the HMRC compliance team put matters this way in one of the documents to which we were taken:

> "This is not one scheme as such, but rather an avoidance device used by a number of firms with mainly irrelevant variations who copied it. There are two scenarios: one where UK resident settlors are interested in trusts whose gains are normally attributed to them for UK CGT purposes under TCGA [i.e. Taxation of Chargeable Gains Tax Act 1992] s.86; and one where any realised gains would be attributed to UK resident beneficiaries who received capital payments from the trust under TCGA s.87."

13. Between 2014 and 2016, HMRC's "Workflow Governance Group" ("WFGG"), which was responsible for determining whether follower notices should be issued, considered at a number of meetings whether such notices should be given in relation to arrangements with similarities to those at issue in *Smallwood*. In some instances, follower notices were approved, in others it was decided that there should be no notice.

14. WFGG approved the giving of the follower notice with which the present appeal is concerned on 13 May 2016. WFGG had been supplied with submissions from others within HMRC seeking approval for follower notices in 11 cases, including that of Mr Haworth. The submissions stated, among other things, this:

> "In general, in all cases the conditions in respect of the Smallwood decision have been met
>
> a. the place of management test is the same as in the UK/Mauritius DTA
>
> b. a UK taxpayer
>
> c. a scheme (or relevant arrangements) devised in the UK
>
> d. the steps taken in the scheme were carefully orchestrated throughout from the UK
>
> e. it was integral to the scheme that the trust should be exported to the overseas territory for a brief temporary period only
>
> f. it was integral to the scheme that the trust should then be returned, within the fiscal year, to the UK
>
> g. effect was given to the integral features of the scheme as designed."

15. WFGG was further referred to a submission dating from November 2015. This included these passages:

> "The Court of Appeal in Smallwood found on the basis of the evidence that the need to ensure that the share sales took place during the Mauritius trusteeship and then that the UK trustees took their place (i.e. that the tax saving scheme was carried out as planned) meant that the POEM of the trust was not Mauritius but *necessarily* in the UK, from where the instructions to Mauritius trustees originated ….
>
> Hughes LJ, giving the leading judgment on the question of POEM, found that the POEM was necessarily in the UK as the inevitable consequence of the tax scheme, the decisions for and direction of which was orchestrated from the UK ….
>
> Advice from Solicitor's Office is that the Tribunal is likely to find similarly if the following facts were present …."

The submission then listed the same seven factors as the 2016 submissions.

16. The last of these passages from the November 2015 submission echoed a record of a decision taken by WFGG in 2014 in which "sols' view" was reported to be that "[i]n another case a Tribunal on balance is likely to find similarly" if facts (a) to (g) were present.

17. HMRC sent Mr Haworth the follower and accelerated payment notices that are at issue before us on 24 June 2016. The follower notice included this:

"On 8 July 2010 the Court of Appeal gave a final ruling in the case of HM Revenue and Customs v Smallwood & Anor [2010] EWCA Civ 778, [2010] STC 2045. The Court ruled that the scheme used in that case did not achieve the intended tax advantage of eliminating Capital Gains Tax on certain disposals.

The trust of which you are settlor used a similar scheme. In my view you have failed by use of the chosen arrangements to achieve the asserted tax advantage of eliminating the capital gains tax that you should pay in respect of the trust's gains.

I consider that the judicial ruling is relevant to you as:

(i) it relates to tax arrangement, that is, to arrangements where the main purpose, or one of the main purposes, is to obtain a particular tax advantage;

(ii) it is a final ruling;

(iii) the principles laid down, or reasoning given, by the Court of Appeal as set out below apply to the tax arrangements used by you or on your behalf; in particular as follows:

1. In the Smallwood case the relevant Double Taxation Convention was that between the UK and Mauritius. The Court reasoned that the following factors indicated that the place of effective management of the relevant Trust for the purposes of Article 4(3) of the UK/Mauritius Double Taxation Convention was in the United Kingdom:

a. the scheme was devised in the United Kingdom on the advice of UK advisors;

b. the steps taken in the scheme were carefully orchestrated throughout from the United Kingdom;

c. it was integral to the scheme that the trust should be exported to Mauritius for a brief temporary period only and then be returned, within the fiscal year, to the United Kingdom;

d. in accordance with the scheme design, the trust was exported to Mauritius for a brief temporary period and duly returned to the United Kingdom within the fiscal year;

e. there was a scheme of management of this trust which went above and beyond the day to day management exercised by the trustees for the time being, and the control of it was located in the United Kingdom.

> 2. The Court of Appeal accordingly found the place of effective management of the trust to be in the UK and hence the trust to be resident in the UK.
>
> 3. Corresponding reasoning applies to the circumstances and implementation of the tax arrangements used by you or on your behalf."

The accelerated payment notice required payment of £8,786,288.40 by 27 September 2016.

18. In a letter dated 22 September 2016, Mazars LLP, Mr Haworth's accountants, made lengthy representations on his behalf as to why the follower and accelerated payment notices should be withdrawn. On 12 December, however, HMRC confirmed the notices. The letter relating to the follower notice included this:

> "You used the Round the World scheme to attempt to avoid tax in the year ended 5 April 2001. Use of the scheme was unsuccessful in *Smallwood*, and HMRC holds the view that the issue of [a follower notice] to you is justified by the principles laid down or reasoning given in that case because if applied to your case, you would be denied the asserted advantage."

19. By then, Mr Haworth had already, on 28 September 2016, issued a claim for judicial review challenging the giving of the follower and accelerated payment notices. The matter came before Sir Ross Cranston, who, in a judgment dated 23 May 2018, dismissed the claim. It is that decision which is the subject of the present appeal.

20. In the meantime, on 31 October 2016, HMRC had issued a closure notice amending Mr Haworth's tax return for the year ended 5 April 2001 to include capital gains of £21,965,721 and an additional capital gains tax charge of £8,786,288.40. On 25 November 2016, Mr Haworth appealed against the notice. His grounds of appeal asserted that, in his case, the POEM of the Mauritian trustees was Mauritius. The appeal proceedings are continuing in the First-tier Tribunal ("the FTT").

The statutory framework

21. Section 204 of FA 2014, which is to be found in chapter 2 of part 4 of the Act, empowers HMRC to give a follower notice to a person (referred to in the Act as "P") if "Conditions A to D" are met. The section proceeds to say this about "Conditions A to D":

> "(2) Condition A is that—
>
> (a) a tax enquiry is in progress into a return or claim made by P in relation to a relevant tax, or
>
> (b) P has made a tax appeal (by notifying HMRC or otherwise) in relation to a relevant tax, but that appeal has not yet been—
>
> (i) determined by the tribunal or court to which it is addressed, or

> (ii) abandoned or otherwise disposed of.
>
> (3) Condition B is that the return or claim or, as the case may be, appeal is made on the basis that a particular tax advantage ('the asserted advantage') results from particular tax arrangements ('the chosen arrangements').
>
> (4) Condition C is that HMRC is of the opinion that there is a judicial ruling which is relevant to the chosen arrangements.
>
> (5) Condition D is that no previous follower notice has been given to the same person (and not withdrawn) by reference to the same tax advantage, tax arrangements, judicial ruling and tax period."

22. Section 205 of FA 2014 explains that the expression "judicial ruling", which features in the definition of Condition C, refers to "a ruling of a court or tribunal on one or more issues" (section 205(2)) and, by section 205(3), that such a ruling is "relevant to the chosen arrangements" if:

> "(a) it relates to tax arrangements,
>
> (b) the principles laid down, or reasoning given, in the ruling would, if applied to the chosen arrangements, deny the asserted advantage or a part of that advantage, and
>
> (c) it is a final ruling".

By virtue of section 205(4), a "judicial ruling" is a "final ruling" if it is:

> "(a) a ruling of the Supreme Court, or
>
> (b) a ruling of any other court or tribunal in circumstances where—
>
> (i) no appeal may be made against the ruling,
>
> (ii) if an appeal may be made against the ruling with permission, the time limit for applications has expired and either no application has been made or permission has been refused,
>
> (iii) if such permission to appeal against the ruling has been granted or is not required, no appeal has been made within the time limit for appeals, or
>
> (iv) if an appeal was made, it was abandoned or otherwise disposed of before it was determined by the court or tribunal to which it was addressed".

23. Section 206 of FA 2014 deals with what a follower notice is to contain. It states:

> "A follower notice must—
>
> (a) identify the judicial ruling in respect of which Condition C in section 204 is met,
>
> (b) explain why HMRC considers that the ruling meets the requirements of section 205(3), and
>
> (c) explain the effects of sections 207 to 210."

24. Section 207 of FA 2014 provides for someone given a follower notice to have an opportunity to raise objections. The section is in these terms:

> "(1) Where a follower notice is given under section 204, P has 90 days beginning with the day that notice is given to send written representations to HMRC objecting to the notice on the grounds that—
>
> (a) Condition A, B or D in section 204 was not met,
>
> (b) the judicial ruling specified in the notice is not one which is relevant to the chosen arrangements, or
>
> (c) the notice was not given within the period specified in subsection (6) of that section.
>
> (2) HMRC must consider any representations made in accordance with subsection (1).
>
> (3) Having considered the representations, HMRC must determine whether to—
>
> (a) confirm the follower notice (with or without amendment), or
>
> (b) withdraw the follower notice,
>
> and notify P accordingly."

25. Where a follower notice is given and not withdrawn, the recipient is liable to pay a penalty of up to 50% of the "denied advantage" (i.e. "so much of the asserted advantage … as is denied by the application of the principles laid down, or reasoning given, in the judicial ruling identified in the follower notice" – see section 208(3) of FA 2014) if "the necessary corrective action is not taken in respect of the denied advantage (if any) before the specified time" (section 208(2)). The "necessary corrective action" requires two steps to be taken:

> "(5) The first step is that—
>
> (a) in the case of a follower notice given by virtue of section 204(2)(a), P amends a return or claim to counteract the denied advantage;

> (b) in the case of a follower notice given by virtue of section 204(2)(b), P takes all necessary action to enter into an agreement with HMRC (in writing) for the purpose of relinquishing the denied advantage.
>
> (6) The second step is that P notifies HMRC—
>
> (a) that P has taken the first step, and
>
> (b) of the denied advantage and (where different) the additional amount which has or will become due and payable in respect of tax by reason of the first step being taken."

The "specified time" is defined in section 208(8) to mean:

> "(a) if no representations objecting to the follower notice were made by P in accordance with subsection (1) of section 207, the end of the 90 day post-notice period;
>
> (b) if such representations were made and the notice is confirmed under that section (with or without amendment), the later of—
>
> (i) the end of the 90 day post-notice period, and
>
> (ii) the end of the 30 day post-representations period".

Section 208(8) also explains that "the 90 day post-notice period" means "the period of 90 days beginning with the day on which the follower notice is given" and "the 30 day post-representations period" means "the period of 30 days beginning with the day on which P is notified of HMRC's determination under section 207".

26. FA 2014 provides for appeals against decisions that penalties are payable but not against follower notices themselves. Under section 214(3), the grounds on which a penalty may be appealed include:

> "(a) that Condition A, B or D in section 204 was not met in relation to the follower notice,
>
> (b) that the judicial ruling specified in the notice is not one which is relevant to the chosen arrangements,
>
> (c) that the notice was not given within the period specified in subsection (6) of that section, or
>
> (d) that it was reasonable in all the circumstances for P not to have taken the necessary corrective action (see section 208(4)) in respect of the denied advantage."

An appeal may result in the tribunal affirming or cancelling HMRC's decision (see section 214(8)), but cancellation "on the ground specified in subsection (3)(d) does not affect the validity of the follower notice, or of any accelerated payment notice or

partner payment notice under Chapter 3 related to the follower notice" (section 214(10)).

27. A follower notice, in contrast, can be challenged, if at all, only by way of judicial review, on public law grounds. More specifically, the recipient may allege *Wednesbury* unreasonableness or that HMRC misdirected themselves.

28. An accelerated payment notice may be given by HMRC in the circumstances set out in section 219 of FA 2014, which is in chapter 3 of part 4 of the Act. Once again, a "Condition C" has to be met. By section 219(4), "Condition C" is here that:

> "one or more of the following requirements are met—
>
> (a) HMRC has given (or, at the same time as giving the accelerated payment notice, gives) P a follower notice under Chapter 2—
>
> (i) in relation to the same return or claim or, as the case may be, appeal, and
>
> (ii) by reason of the same tax advantage and the chosen arrangements;
>
> (b) the chosen arrangements are DOTAS arrangements;
>
> …".

"DOTAS arrangements" are, by section 219(5):

> "(a) notifiable arrangements to which HMRC has allocated a reference number under section 311 of FA 2004,
>
> (b) notifiable arrangements implementing a notifiable proposal where HMRC has allocated a reference number under that section to the proposed notifiable arrangements, or
>
> (c) arrangements in respect of which the promoter must provide prescribed information under section 312(2) of that Act by reason of the arrangements being substantially the same as notifiable arrangements within paragraph (a) or (b)".

29. Where an accelerated payment notice goes unpaid, the recipient can be liable to penalties under section 226 of FA 2104.

30. The explanatory notes published in relation to the clauses which became part 4 of FA 2014 explained that they "introduce[d] two new consequences for certain users of tax arrangements": first, "a power for HMRC to issue a 'follower notice' where those tax arrangements have been shown in a relevant ruling not to give the asserted tax advantage" and, secondly, "a requirement to pay the amount of the asserted tax advantage to HMRC on receipt of an 'accelerated payment notice'". The "background note" included in the explanatory notes explained as follows:

> "HMRC sometimes have to deal with a large number of taxpayers' returns that claim a tax advantage from the same or similar tax arrangements, or large numbers of appeals against HMRC's conclusion that the arrangements do not work. This measure gives HMRC the power to issue a notice to a taxpayer to the effect that they should settle their case with HMRC once a tribunal or court has concluded in another party's litigation that the arrangements do not produce the asserted tax advantage."

31. The present appeal gives rise to two issues as to the interpretation of section 205(3)(b) of FA 2014. The first relates to the words "principles laid down, or reasoning given". Mr Goodfellow submitted that these words refer exclusively to points of law determined in the "judicial ruling" in question. "Reasoning", he observed, is a translation into English of "ratio", and the "ratio decidendi" of a case is recognised as its *legal* basis. That section 205(3)(b) is referring exclusively to points of law is also, Mr Goodfellow submitted, apparent from its origins. When draft legislation was first published, in January 2014, it provided for a judicial ruling to be relevant if "the principles laid down in the ruling would, if applied to the applied arrangements, deny the asserted advantage, or a part of that advantage" (clause 4(3)(b)); there was no mention of "reasoning". In March 2014, HMRC published a document ("Tackling marketed tax avoidance: Summary of Responses") in which they commented on responses to their consultation "Raising the stakes on tax avoidance" that had addressed points relating to the draft clauses in respect of follower notices. Having recorded that concern had been expressed that "[t]he term 'principles' is too broad and could catch a wider range of disputes than is contended" (paragraph 3.5), this was said in paragraph 3.7:

> "The Government accepts some of the concerns raised about reliance solely on the term 'principles'. Some respondents saw this approach as being capable of applying a judgement that, for example, an item of expenditure was not incurred 'wholly and exclusively for the purposes of the trade' to any case where that was the point in dispute. This is not the Government's intention. The proposal aims to focus on the tribunal's or court's reasoning behind the decision. The Government will make changes to the proposed legislation to make this aspect clearer."

"Reasoning", Mr Goodfellow said, must have been introduced into what became section 205(3)(b) with this in mind. The purpose of the change will accordingly have been to *narrow* the scope of the legislation.

32. Mr Goodfellow's contention, if correct, would have obvious significance where a "judicial ruling" related to an appeal from a finding of fact. The circumstances in which such a finding is susceptible to challenge in a tax context were explained by the House of Lords in *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14. Viscount Simonds there said (at 29) that a finding of fact should be set aside if it appeared that it had been made "without any evidence or upon a view of the facts which could not reasonably be entertained". In a similar vein, Lord Radcliffe referred (at 36) to the facts found being "such that no person acting judicially and properly instructed as to

the relevant law could have come to the determination under appeal". Someone wishing to take issue with a factual finding made by, say, the FTT must thus show why it was not *entitled* to make the finding.

33. In a case in which HMRC had succeeded in reversing a finding of fact adverse to them on the footing that the only reasonable conclusion was to the contrary, there would be no doubt but that they could rely on the decision of the appellate Court or Tribunal. If, on the other hand, a finding of fact favourable to HMRC had been upheld on appeal, the extent to which they could rely on that might be limited. The legal foundation for the appellate decision would be that the FTT had been entitled to find as it did, not that it was necessarily correct to do so. That, moreover, might be said to be so even if the judges had said that they would have taken the same view as the FTT. Such comments would not obviously form part of the ratio.

34. In my view, however, Mr Goodfellow's argument is not well-founded. The insertion of the words "or reasoning given" into what is now section 205(3)(b) simply cannot be taken to have had a narrowing effect. Sir Ross Cranston thought it clear that "'principles laid down' and 'reasoning given' are separate and alternative concepts" (see paragraph 85 of his judgment). I agree. The addition of "reasoning" cannot be read as limiting "principles", but must rather have extended what can be drawn from a ruling. "Principles" and "reasoning" are *both* relevant. In the circumstances, it seems to me that HMRC are not constrained to have regard only to the ratio of a case, but can also take into account other reasoning to be found in it. Were, say, appellate judges both to conclude that the FTT had been entitled to make a finding of fact and to say that they agreed with it, there could be no doubt but that the latter comment could be material. Of course, though, the fact that an observation did not form part of the ratio could potentially have a bearing on the weight to be attached to it.

35. The second interpretation issue concerns the word "would" (in "the principles laid down, or reasoning given, in the ruling *would*, if applied to the chosen arrangements, deny the asserted advantage or a part of that advantage" – emphasis added). Mr Timothy Brennan QC, who appeared with Mr Christopher Stone for HMRC, argued that this requires no more than that HMRC consider that the principles or reasoning are more likely than not to result in the advantage being denied. Mr Goodfellow, on the other hand, submitted that HMRC are required to be of the opinion that the principles or reasoning *will* deny the advantage and suggested that follower notices can properly be given only where HMRC believe that there is no real prospect of the taxpayer succeeding in an appeal to the FTT.

36. I agree with Mr Goodfellow that it is not enough to satisfy section 205(3)(b) of FA 2014 that HMRC consider that the principles or reasoning in a ruling would be more likely than not to deny the advantage. My reasons include these:

    i) As was pointed out by Mr Goodfellow, the word "would" implies that HMRC must be of the opinion that, should the point be tested, principles or reasoning found in the ruling in question *will* deny the advantage. As a matter of language, that appears to me to demand more certainty than just a perception that there is a 51% chance of the advantage being denied;

    ii) Mr Brennan observed that, had Parliament intended section 205(3)(b) to be applicable only where an appeal on the part of the taxpayer was thought to be

hopeless, it could have stated so. Neither, however, has Parliament said that it is good enough that the principles/reasoning would be more likely than not to deny the advantage;

iii) Mr Brennan's construction of section 205(3)(b) would allow follower notices to be given in a surprisingly wide range of cases. There would seem, for example, to be no bar on such a notice being given if HMRC believed there was a 51% chance of a high-level principle found in a decided case (say, the *Ramsay* approach applied recently in *UBS AG v Revenue and Customs Commissioners* [2016] UKSC 13, [2016] 1 WLR 1005) being held to apply in a quite different factual situation. On this basis, it would theoretically be possible for HMRC to use follower notices routinely in relation to disputes pending before the FTT. After all, HMRC's "Litigation and Settlement Strategy" explains in paragraph 16 that they "will not usually persist with a tax dispute unless it potentially secures the best practicable return for the Exchequer and *HMRC has a case which it believes would be successful in litigation*" (emphasis added). Yet, as can be seen from the explanatory notes, the provisions relating to follower notices were directed at a case where "a tribunal or court has concluded in another party's litigation that the arrangements do not produce the asserted tax advantage". I can see no indication that follower notices were meant to be available to HMRC otherwise than in relatively exceptional circumstances;

iv) The serious consequences that can flow from a follower notice are important here. The recipient is exposed to the risk of having to pay a penalty of up to 50% of the amount at stake plus smaller penalties if he does not comply with an accelerated payment notice. Parliament might be expected to have intended such a regime to be applicable only in a limited class of cases;

v) "The constitutional right of access to the courts is inherent in the rule of law", "impediments to the right of access to the courts can constitute a serious hindrance even if they do not make access completely impossible" and "[e]ven where a statutory power authorises an intrusion upon the right of access to the courts, it is interpreted as authorising only such a degree of intrusion as is reasonably necessary to fulfil the objective of the provision in question" (*R (UNISON) v Lord Chancellor* [2017] UKSC 51, [2017] 3 WLR 409, at paragraphs 66, 78 and 80, per Lord Reed). Since receipt of a follower notice may deter a taxpayer from resort to the FTT, this principle provides a further reason for interpreting section 205(3)(b) as calling for more than just a 51% chance of principles/reasoning from an earlier case being held to apply;

vi) An analogy, albeit a rather imperfect and remote one, can be found in the law relating to value added tax ("VAT"). The decision of the Court of Justice of the European Union in Joined Cases C- 439/04 and C-440/04 *Kittel v Belgium; Belgium v Recolta Recycling SPRL* [2008] STC 1537 established that the right of a person registered for VAT to deduct input tax can be refused where:

> "it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT"

> (see paragraphs 59 and 61 of the judgment). In *Mobilx Ltd v Revenue and Customs Commissioners* [2010] EWCA Civ 517, [2010] STC 1436, the Court of Appeal held that the fact that a trader knew or should have known that a transaction was *more likely than not* to be connected with fraudulent evasion of VAT would not suffice. Moses LJ said (at paragraph 60):
>
> "The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion".
>
> This echoed the observation of Morritt C in *Blue Sphere Global Ltd v Revenue and Customs Commissioners* [2009] EWHC 1150 (Ch), [2009] STC 2239 (at paragraph 54):
>
> "The relevant knowledge is that BSG ought to have known that by its purchases it was participating in transactions which were connected with the fraudulent evasion of VAT; that such transactions might be so connected is not enough."

37. In a similar way, it seems to me that, to give a follower notice, HMRC must be of the opinion that the principles or reasoning in the ruling in question *would* deny the advantage, not merely that they would be more likely than not to do so. That implies, I think, a substantial degree of confidence in the outcome.

The basis of the present appeal

38. It is Mr Haworth's case, first, that HMRC misdirected themselves in certain respects when deciding to give him the follower notice of June 2016 and, secondly, that that notice in any event failed to satisfy the requirements of section 206 of FA 2014. He contends that the follower notice and the accelerated payment notice based on it should therefore both be quashed.

39. Mr Haworth also attacked Sir Ross Cranston's decision on the ground that, contrary to the judge's view, the words "principles laid down, or reasoning given", as used in section 205(3)(b) of FA 2014, refer only to points of law determined in the "judicial ruling". I have already, however, rejected that contention.

Misdirection

40. Mr Goodfellow maintained that HMRC misdirected themselves in two key respects. In the first place, HMRC misunderstood and overstated the significance of Hughes LJ's judgment in the *Smallwood* case. Secondly, HMRC erroneously proceeded on the basis that a follower notice could be given if they were merely of the opinion that it was more likely than not that principles/reasoning in *Smallwood* would deny Mr Haworth the asserted tax advantage. I shall take these points in turn.

Hughes LJ's judgment

41. Mr Goodfellow's criticism was essentially that HMRC proceeded on the basis that Hughes LJ had held in *Smallwood* that the POEM was in the UK when he had actually been saying no more than that the Special Commissioners had been *entitled* to arrive at that conclusion.

42. I have referred in paragraphs 14 and 15 above to the submissions that were before WFGG when they decided to approve the follower notice given to Mr Haworth. It will be seen that those submissions stated that in *Smallwood* the Court of Appeal found that "the need to ensure that the share sales took place during the Mauritius trusteeship and then that the UK trustees took their place … meant that the POEM of the trust was not Mauritius but *necessarily* in the UK" and that Hughes LJ "found that the POEM was necessarily in the UK as the inevitable consequence of the tax scheme".

43. Hughes LJ did not in fact go that far. It can be seen from his judgment, from which I have quoted in paragraph 10 above, that he had *Edwards v Bairstow* well in mind. He explained that the taxpayer could succeed "only if the Special Commissioners reached a conclusion of fact which was simply not available to them, and thus made an error of law" (paragraph 67) and that he did "not think that it is possible to say that [the Special Commissioners] were not entitled to find that the POEM of the trust was in the United Kingdom in the fiscal year in question" (paragraph 70). Shorn of context, the final sentence of paragraph 70 ("There was a scheme of management of this trust which went above and beyond the day to day management exercised by the trustees for the time being, and the control of it was located in the United Kingdom") could be taken to represent Hughes LJ's *own* view of the position, but Mr Brennan fairly accepted that, in the light of what had been said earlier, Hughes LJ is better understood as having meant no more than that it was open to the Special Commissioners to make such a finding.

44. In the circumstances, I agree with Mr Goodfellow that HMRC overstated Hughes LJ's conclusions in *Smallwood* and so misdirected themselves.

Probability of denial

45. As I have said (paragraph 37 above), it seems to me that, to give a follower notice, HMRC must be of the opinion that the principles or reasoning in the ruling in question *would* deny the relevant advantage, not merely that they would be more likely than not to do so. However, the submissions before WFGG spoke of what a Tribunal would be "likely" to find. Thus, the November 2015 submission recorded that advice from Solicitor's Office was that "the Tribunal is likely to find similarly if the following facts are present", echoing a record of a previous decision by WFGG in which there was reference to the Solicitor's Office being of the view that "a Tribunal on balance is likely to find similarly" (see paragraphs 15 and 16 above). In the circumstances, it can be inferred that, when deciding to approve a follower notice in Mr Haworth's case, WFGG was proceeding on the basis that *likelihood* was good enough, not asking itself whether principles/reasoning in *Smallwood would* deny Mr Haworth the tax advantage. This, to my mind, involved a further misdirection.

Consequences

46. In the course of his attractively presented submissions, Mr Brennan argued that HMRC could rationally conclude that principles/reasoning in *Smallwood* would deny Mr Haworth the tax advantage. That contention does not, however, meet the complaint of misdirection. In my view, it is apparent that HMRC did misdirect themselves in the two respects I have mentioned. Further, it cannot, I think, be concluded that HMRC would have been bound to arrive at the same conclusion in the absence of the misdirections, nor even that they would have been highly likely to do so. It is possible that HMRC would still have decided to give a follower notice, but that is by no means self-evident.

47. Mr Brennan took us to paragraph 106 of Sir Ross Cranston's judgment, in which he said:

> "To put it in general terms, albeit that Mr Gujadhur and Deloitte & Touche Offshore Services Ltd as the trustees in Mauritius might have acted in some day to day matters independently, and albeit that Pinsent Curtis in particular was careful to avoid any suggestion that they were instructing the trustees, the highly likely conclusion for HMRC which would have followed from consideration of this evidence is obvious: the arrangements in the claimant's case were being run from the UK to a pre-arranged plan and *Smallwood* was the relevant judicial ruling."

However, Sir Ross Cranston made these remarks in the context of a (now irrelevant) complaint that "there was no evidence that anyone in HMRC completed a review in the claimant's case as to the POEM of the trust and whether or not a follower notice could be issued" (see paragraph 99 of the judgment). He was not considering whether HMRC would have decided to give Mr Haworth a follower notice even if they had not misdirected themselves in the respects I have identified. I do not think, therefore, that he can be taken to have expressed the view that HMRC would have been highly likely to have decided to give Mr Haworth the follower notice if they had directed themselves correctly.

48. In the circumstances, it seems to me that the right course must be to allow Mr Haworth's appeal and to quash both the follower notice he was given and the accelerated payment notice that was based on it.

Section 206 of FA 2014

49. The conclusions I have arrived at thus far are sufficient to dispose of the present appeal. Even so, I ought, I think, to address Mr Goodfellow's alternative submission: that the follower notice that Mr Haworth was given did not meet the requirements of section 206 of FA 2014.

50. Section 206 of FA 2014 stipulates that a follower notice must, among other things, "identify the judicial ruling in respect of which Condition C in section 204 is met" and "explain why HMRC considers that the ruling meets the requirements of section 205(3)". It follows, having regard to the terms of section 205(3), that it is incumbent

on HMRC to explain why they consider that "the principles laid down, or reasoning given, in the ruling would, if applied to the chosen arrangements, deny the asserted advantage or a part of that advantage".

51. Mr Goodfellow maintains that the follower notice given to Mr Haworth did not meet this requirement, but Sir Ross Cranston disagreed. He said this in paragraph 92 of his judgment:

> "In my view the follower notice itself provided, albeit succinctly, an explanation of why HMRC considered that *Smallwood* was the relevant judicial ruling and that corresponding reasoning applied to the claimant's case. There is no statutory requirement to set out the detailed facts or to identify the scheme documents relied upon by HMRC for its conclusion that the *Smallwood* hallmarks are present."

52. Like Sir Ross Cranston, I do not think that a follower notice need be lengthy. A follower notice is, of course, an important document, but, as Sir Ross Cranston noted, the legislation does not oblige HMRC to go into the facts in detail, let alone to deploy all their evidence. A relatively concise explanation should be enough and may well make for clarity.

53. Even so, I have in the end concluded, with a degree of hesitation, that the follower notice given to Mr Haworth was deficient. The problem, as I see it, stems from paragraph (iii)(3) of the passage from the notice quoted in paragraph 17 above. It can be inferred from it that HMRC considered that each of the features listed in (a) to (e) of paragraph (iii)(1) existed in Mr Haworth's case, but there was no further explanation of why that was thought to be so. Mr Haworth's liability to tax depended on whether the POEM of the trust he had established was in the United Kingdom during the period it had Mauritian trustees. *Smallwood* shows that the test to be applied is that derived from the commentary extract set out on paragraph 9 above and, hence, that (in words of Patten LJ) "what has to be identified is the place where the real top-level management of the trustee qua trustee occurred rather than the day to day administration of the trust". The follower notice given to Mr Haworth, however, said nothing specific about why the "real top-level management" of the Mauritian trustees was believed to be in the United Kingdom. The notice was, rather, framed in generic terms. In my view, it needed to give Mr Haworth somewhat more information about why, in his particular case, "real top-level management" was thought to be in the United Kingdom.

54. Mr Goodfellow argued that the fact that the follower notice given to Mr Haworth was deficient was fatal to its validity. Mr Brennan, on the other hand, contended that the notice should not be quashed even if it was defective.

55. In the past, Courts would ask themselves whether statutory requirements were "mandatory" or "directory". Failure to comply with a requirement that was considered to be "mandatory" would necessarily result in invalidity, while non-compliance with a "directory" requirement need not do so. However, in *R v Soneji* [2006] 1 AC 340 Lord Steyn said (at paragraph 23) that "the rigid mandatory and directory distinction, and its many artificial refinements, have outlived their usefulness". Instead, he said,

"the emphasis ought to be on the consequences of non-compliance, and posing the question whether Parliament can fairly be taken to have intended total invalidity".

56. More recently, in *Secretary of State for the Home Department v SM (Rwanda)* [2018] EWCA Civ 2770 (at paragraphs 51 and 52) Haddon-Cave LJ endorsed as "applicable in all administrative law cases where questions of statutory construction and validity arise" the two-stage approach which Burnett J had formulated in *North Somerset DC v Honda Motor Europe Ltd* [2010] EWHC 1505 (QB). Burnett J had said this in the *North Somerset* case (at paragraph 43):

> "It is clear from the analysis in *Soneji* that in any case concerning the consequences of a failure to comply with a statutory time limit, there are potentially two stages in the inquiry. The first is to ask the question identified by Lord Steyn: did Parliament intend total invalidity to result from failure to comply with the statutory requirement? If the answer to that question is 'yes', then no further question arises. Yet if the answer is 'no' a further question arises: despite invalidity not being the inevitable consequence of a failure to comply with a statutory requirement, does it nonetheless have that consequence in the circumstances of the given case and, if so, on what basis? It is at this second stage that the concept of substantial compliance may yet have a bearing on the outcome."

57. Mr Goodfellow pointed out that section 206 of FA 2014 uses the word "must" rather than "shall". In *R v McLaughlin* [2018] NICA 5, the Northern Ireland Court of Appeal held that non-compliance with a provision stating that the Court "must not exercise" a power to make a confiscation order without giving interested parties a reasonable opportunity to make representations was fatal. In the course of giving the judgment of the Court, Deeny LJ said this:

> "62. It is clear that the judge was exercising a power under s.160A (1) [of the Proceeds of Crime Act 2002]. It was therefore mandatory on him to give a reasonable opportunity to both Mrs McLaughlin and the mortgagee. The traditional word used to indicate a mandatory requirement rather than a discretionary one was 'shall' as opposed to 'may'. It is true that this has been the subject of close examination on occasions. But where the legislator has chosen to use the imperative 'must' there can be no debate as to the mandatory nature of the provision. To ignore such a clear expression would be to ignore the clear intention in the legislation. For a court to do so would indeed seem to be unconstitutional.
>
> …
>
> 67. The use of the 'must' is a strong indication of what Parliament intended. This is reinforced by the provision in Section 160A (3) making the judge's finding at this stage 'conclusive'."

58. However, failures to comply with section 206(3)(b) of FA 2014 may vary enormously in their importance, from the egregious and damaging to the minor and inconsequential. I do not think Parliament can fairly be taken to have intended that total invalidity should result from *any* irregularity, regardless of the extent of the default and the seriousness of its consequences. The fact that the word "must" has been used does not in the context of section 206 of FA 2014 seem to me to imply total invalidity. The Northern Ireland Court of Appeal was considering the significance of the word in a very different context.

59. Should the fact that the follower notice given to Mr Haworth was deficient nonetheless produce invalidity here? On balance, I do not think so, for the following reasons:

i) This is by no means a case of wholesale or egregious non-compliance. HMRC provided information with a view to satisfying section 206(3)(b), albeit that I have ultimately concluded that they fell short;

ii) As Sir Ross Cranston said in paragraph 93 of his judgment, Mr Haworth "well knew the background to HMRC's thinking about the arrangements he had effected". Sir Ross Cranston explained:

> "Among other things there was HMRC's letter to the claimant on the application of *Smallwood* in August 2012; HMRC's meeting stencil given to the claimant's then advisers, KPMG, in early February 2013, which identified what HMRC considered to be the key documents and the application to them of the *Smallwood* 'pointers'; and the email dated 22 May 2014 to Mazars with its table setting out in narrative form why HMRC considered that the *Smallwood* 'pointers' were present in his case, again by reference to the underlying documents. Three weeks later on 12 June 2014, under cover of Ms Noble's letter, Mazars was provided with an itemised list of the documents held by HMRC, identifying which documents were said to demonstrate that the *Smallwood* 'pointers' were present"; and

iii) There is no reason to suppose that Mr Haworth was caused any prejudice. Notwithstanding the follower notice's shortcomings, Mazars were able to address its merits in depth in their letter of 22 September 2016 (as to which, see paragraph 18 above). The letter included a detailed explanation of why *Smallwood* was said to be distinguishable and why Mr Haworth's trust's POEM was said to be in Mauritius. In the particular circumstances, Mr Haworth did not need the follower notice to contain any additional information to be in a position to respond to it.

60. In all the circumstances, I would not have quashed the follower and accelerated payment notices for failure to comply with section 206 of FA 2014.

Conclusion

61. In the light of my conclusions on misdirection, I would allow the appeal and quash the follower and accelerated payment notices given to Mr Haworth.

Sir Timothy Lloyd:

62. I agree with the judgment of Newey LJ and also with that of Gross LJ.

Lord Justice Gross:

63. I too would allow the appeal and quash the notices in question, for the reasons given by Newey LJ, with which I entirely agree.

64. I add only a very few words of my own.

65. First, with a view to addressing tax avoidance, I can well understand the utility of the powers conferred on HMRC to give follower and accelerated payment notices in cases falling within the statutory framework. As explained by Lewis J in *R (Broomfield) v HMRC* [2018] EWHC 1966 (Admin); [2018] STC 1790, at [80]:

> "The purposes underlying Ch 2 of Pt 4 of the 2014 Act appear from the terms of the legislation. The aim is to discourage taxpayers from making claims, or maintaining appeals, which seek tax advantages arising out of schemes which have already been the subject of final rulings by a court or tribunal. The aim is, broadly, to deter further litigation on points already decided by the relevant judicial court or tribunal and to deter taxpayers from spinning out disputes with the Revenue when the issues have already been resolved. Deterring taxpayers from relitigating points is intended to reduce the administrative and judicial resources needed to deal with such claims and appeals to ensure that the taxpayer does not continue to have the benefit of retaining the amount of the disputed tax until the dispute is resolved. Those aims are to be achieved by making taxpayers liable to a penalty if they continue to make such claims or maintain such appeals and by requiring them to pay the disputed tax immediately. "

66. Secondly, given the draconian nature of these powers conferred on HMRC, it is right that they should be carefully circumscribed, not least – amongst other reasons – because of their impact on access to the courts and the rule of law: *R (Unison) v Lord Chancellor* [2017] UKSC 51; [2017] 3 WLR 409, at [66] and following, *per* Lord Reed JSC (as he then was). The interpretation of ss. 204 and 205 of the FA 2014 set out by Newey LJ, serves to confine the exercise of these powers to their proper sphere and in accordance with their true statutory purpose.

67. Thirdly, in the present case, HMRC misdirected themselves by placing more weight on the decision in *Smallwood v R&C Comrs* [2010] EWCA Civ 778; [2010] STC 2045, than it can bear. Correctly understood, the judgment of Hughes LJ (as he then was), especially at [67] and [70], went no further than holding that the Special Commissioners had been entitled to conclude that the POEM of the trust there in issue was in the United Kingdom. On that footing, however, the "principles laid down, or reasoning given" (FA 2014, s.205(3)(b)) in *Smallwood* do not suffice to assist HMRC here.

68. Fourthly, as the test generally applied by HMRC when considering litigation is whether they are "likely to succeed", it strikes me as implausible that Parliament intended mere likelihood of success to suffice for HMRC to form the opinion that a judicial ruling "*would*, if applied to the chosen arrangements, deny the asserted advantage…" (FA 2014, s.205(3)(b), italics added), so that follower and accelerated payment notices could properly be given. A test of likelihood of success would permit the invocation of these powers in a range of cases outside their statutory purpose. In this respect too, HMRC misdirected themselves; as Newey LJ has expressed it, "a substantial degree of confidence in the outcome" was instead required.

69. Fifthly, as to the explanation required by FA 2014, s.206, the vice here (as Newey LJ has identified) was not the *brevity* of the follower notice but the want of proper *explanation*. Nothing said in this judgment should be taken as lending encouragement to lengthier notices or "defensive" drafting.