Tax Administration Research Centre

# HMRC'S DISCRETIONARY APPROACHES TO TAX FRAUD

## FILM TAX AVOIDANCE SCHEMES

University of Exeter Business School

ESRC Economic & Social Research Council

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# Cheating the Public Revenue

'Cheating can include any form of fraudulent or dishonest conduct by the defendant to prejudice the Revenue's right to the tax in question knowing that he has no right to do so.'

Judge Hardy, *R v Less* (*The Times*, March 30, 1993)

'There can be no logical or principled basis for the meaning of dishonesty (as distinct from the standards of proof by which it must be established) to differ according to whether it arises in a civil action or a criminal prosecution.'

Lord Hughes, *Ivey v Genting Casino* [2017] UKSC 67 [63].

# Cheating in Criminal and Civil Law

## Criminal Offence

- Crime of cheating the public revenue

*Beyond reasonable doubt.*

*Acts upon the fraudster, and inflicts a penalty.*

## Civil Wrong

- Tort of cheating the public revenue (Lord Mance, *HMCE v Total Network* [2008] UKHL 19 at [121].
- The Ramsay principle

*Balance of probability.*

*Acts upon the fraud, and unravels it.*

# Legal Interpretation Dispute

**Legal interpretation** is where the customer's and HMRC's interpretation of the law and how it applies to the facts result in a different tax outcome, and **there is no avoidance**.

# Tax Avoidance Dispute

**Avoidance** is exploiting the tax rules to gain a tax advantage that Parliament never intended. It often involves **contrived, artificial transactions that serve little or no commercial purpose other than to produce a tax advantage**.

Tax avoidance is not the same as tax planning. **Tax planning** involves using tax reliefs for the purpose for which they were intended. For example, claiming tax relief on capital investment.

# The Constructional Approach

‘Whenever the Court decides a tax dispute it legislates about taxation. Anyone who has decided tax appeals knows that <u>most</u> of them concern **transactions which Members of Parliament and the draftsman of the Act had not anticipated**. <u>Some</u> of the **transactions** are **of a kind which had never taken place before the Act was passed**: they were **devised as a result of it**.’

Lord Diplock, *The Courts As Legislators,* p.6

# Sideways Loss Relief

- Profits and losses of an LLP are treated as those of its members if it “carries on a trade with a view to profit”: section 863 Income Tax (Trading and Other Income) Act 2005.

- Each member of an LLP can use his share of the LPP’s loss to reduce his other taxable income and thus tax liability: section 64 Income Tax Act 2007.

# Film Partnership Scheme

- Promoters form an LLP. Taxpayers contribute money and become members of the LLP.
- LLP buys assets (rights to income from films) with taxpayers' money (30%) and loan (70%).
- LLP immediately writes down assets (representing their net realisable value in an unpredictable industry) to generate a loss.
- 100% of loss is allocated to the members based on their contributions to claim sideways loss relief.

# Tax Avoidance & Tax Evasion

- **Tax Avoidance**
- T’s taxable income = £1M
- T declared £1M on tax return
- T claimed loss relief of £1M
- Tax paid = £0
- Tax loss = £400K

**Tax Evasion**

- T’s taxable income = £1M
- T declared £0 on tax return
- T concealed £1M from the Revenue
- Tax paid = £0
- Tax loss = £400K

# Stages of a Tax Avoidance Scheme

1. Promoters devise the scheme.
2. Q.C. ‘blesses’ the scheme for a fee.
3. Taxpayer’s accountant recommends the scheme for a commission.
4. Taxpayer buys the scheme and claims loss relief in tax return.
5. Revenue decides that taxpayer is not entitled to relief and demands the tax.

# Taxpayers' Appeal

- Taxpayers appealed to the Tax Tribunal.
- ***Ingenious Games LLP & Ors v HMRC*** [2015] UKUT 105 (TCC).
- ***Eclipse Film Partners No 35 LLP v HMRC*** [2015] EWCA Civ 95.

- Main issue: whether the LLPs "carried on a trade with a view to profit" under s. 863 ITOIA 2005.
- Tribunal held that they did not.
- Result was no sideways loss relief.

# Taxpayers' fraud claims

- Taxpayers sued the promoters and banks involved to recover their losses.
- *Anthony Barness & Ors v Ingenious Media & Ors* (FS-2017-000005)
- *Christopher Upham & Ors v. HSBC Bank* (CL-2020-000347).

- Claims include: fraudulent misrepresentation, deceit and unlawful means conspiracy.
- Basis is that the schemes were a fraud.

# Criminal Prosecution

- HMRC/CPS prosecuted the promoters and users of the schemes.
  - ***R v Terrence Potter & Ors*** (2015-2016). Southwark Crown Court.
  - ***R v. Keith Hayley & Ors*** (2016). Birmingham Crown Court.

- Main issue: whether the promoters and users conspired to cheat the Revenue by inflating the LLP's losses.
- The jury decided that they did.
- The result was imprisonment.

# Conclusions

- The rule of law requires civil proceedings to be aligned with criminal proceedings by applying the common law of cheating the public revenue.
- The legal principle is the same. The procedural differences result from the nature of criminal and civil proceedings: standard of proof and consequence.
- HMRC should ask the courts to recognise the *Ramsay* principle as an application of the common law of cheating and extend it to the professional enablers of tax avoidance.

# Lord Wilberforce - Ramsay Principle

‘In the courts below, attention was concentrated upon the question whether the gain was exempt from tax or not. The Court of Appeal decided that it was not. In this House, the Crown, while supporting this decision, mounted a fundamental attack upon the whole of the scheme. It contended that it should simply be disregarded … as **fiscally, a nullity**, not producing either a gain or a loss.’