

# Analysis

## Finance Bill 2014: Follower notices and accelerated payments

**R**arely do government proposals generate so much adverse comment and intense lobbying from the tax and legal professions. The Finance Bill proposals require 'accelerated payment' of the tax in dispute in avoidance cases. They will also impose a penalty if a taxpayer litigates and loses a case after receiving a 'follower notice' in which HMRC opines the issue has already been determined by other litigation. This has been described as 'unconstitutional' and as having the effect of making HMRC 'judge and jury'.

The proposals will apply where there is an open enquiry or tax appeal in relation to 'tax arrangements' – namely, where it is reasonable to conclude that obtaining a 'tax advantage' was the main purpose or one of the main purposes of the 'arrangements'. Given the breadth of this definition, the changes may affect the activity of large corporates; however, they are designed principally to help break the logjam of unresolved avoidance cases involving high net worth individuals. HMRC has calculated that 43,000 of 65,000 such cases are potentially affected. HMRC has been lobbied by many to abandon the retrospective aspects of these proposals; and it has openly admitted that it expects to be heavily challenged in litigation, including by way of judicial review, and has set resources aside for the fight.

### Follower notices

The first weapon in the proposed arsenal is a 'follower notice'. (At one stage, HMRC had labelled these 'failure notices' but has sensibly returned to less emotive language.) HMRC believes that even when it wins a piece of litigation, other users of that scheme or of similar schemes claim their cases are 'different'. This ties up a lot of HMRC resources in chasing down individual cases. The follower notice is designed to tackle this behaviour by threatening a large penalty if the taxpayer does not promptly fold.

HMRC may issue a notice where 'HMRC is of the opinion that there is a judicial ruling which is relevant to the chosen arrangements'. The ruling must itself relate to tax avoidance. A ruling is 'relevant' if the 'principles' laid down or the 'reasoning given' in the ruling would, if applied to the arrangements, deny the asserted advantage (or part of it).

The government has added the reference to 'reasoning' in response to feedback, accepting that the reference to principles alone left the ambit of the measure too wide. However, it is not easy to see that the change helps much. If the government intends to prevent users of ostensibly similar schemes from dragging their feet, the legislation ought to stipulate that the facts of the case in hand should be similar to those in the relevant ruling. The consultation response assures us that notices will only be issued following approval at senior level and will be scrutinised by staff who have not been working on the case. Given the impact of a notice, this does not

**SPEED READ** Controversial measures to tackle mass marketed avoidance are going through Parliament. They seek to remove cash flow and perceived procrastination advantages under the current regime for resolving tax disputes. The measures give HMRC the ability to issue 'follower notices', where it believes that there is a final 'judicial ruling which is relevant to the chosen arrangements'; and 'accelerated payment notices', requiring the taxpayers to make upfront payments of the disputed tax, pending the outcome of an enquiry or tax appeal. A payment notice may be issued: following a follower notice; if the 'chosen tax arrangements' are 'DOTAS arrangements'; or if a GAAR counteraction notice is or has been given. Taxpayers who expect to be affected by these measures need to consider their options, including any grounds for challenge.



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represent much of a safeguard.

The relevant ruling must be 'final'. 'Final' means that the ruling was given in litigation which is no longer capable of appeal, which has not been appealed or where an appeal has been abandoned. Controversially, a decision of the First-tier Tribunal can be 'final' in these circumstances, despite the fact that it is not a court of precedent so its decisions are not binding on others. HMRC's justification is that promoters might 'game' the system by arranging for one scheme user to go to the tribunal and, if they lose, be 'bailed out' financially by the rest of the users, with another user rising to bring their own appeal without any of them drawing a follower notice in the meantime – and presumably repeating *ad infinitum*.

## The fear is that, in the short term at least, HMRC has added an extra layer of ground for dispute

A notice requires the taxpayer to undertake 'corrective action', by amending a return or claim or, in the case of an appeal, settling that dispute. The taxpayer can make representations to object to the notice. The taxpayer is liable to a penalty if he does not take the necessary 'corrective action' within 90 days of the notice; or, if representations have been made within the 90 days, within 30 days of HMRC confirming the notice in response (if later than the original 90 days). Presumably, taxpayers will therefore be in no hurry to make early

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representations. The penalty is 50% of the 'denied tax advantage'. This can be reduced for cooperation but not to less than 10%.

### Challenge

The consultation response accepts that a taxpayer has the right not to take the corrective action and to proceed with their own tax appeal. However, there is no statutory right of appeal against the giving of a notice. A taxpayer who disagrees that the ruling is relevant may therefore only be left with the option of bringing a judicial review of HMRC's decision to issue the notice, despite the taxpayer's representations against doing so. A successful judicial review would require HMRC to withdraw the follower notice.

If a judicial review is unsuccessful or not brought at all, a taxpayer would need to bring the tax appeal with the threat of a penalty hanging over the case like the sword of Damocles. HMRC says: "The intention is that the penalty will apply where the dispute is resolved on the same basis as the "relevant judgment" cited in the 'follower notice'". It also says: "The taxpayer's appeal against the penalty can include the contention that HMRC should not have issued the "follower notice" in the first place because the judicial decision cited was not "relevant"."

The first point to note is about timing. A penalty assessment can be raised during the course of the substantive tax appeal, and indeed HMRC must issue one if the follower notice was given during the course of an enquiry. Payment of the penalty is, however, suspended for the duration of the penalty appeal – so it will be possible to avoid paying the penalty during the substantive tax appeal provided the penalty appeal can be stood over behind it.

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Second, it is not clear how to square HMRC's statements of principle with the draft legislation. A taxpayer is liable to a penalty for not undertaking the corrective action required by a notice (which is not withdrawn) *within the specified time*. There is no right of appeal against the validity of the notice itself. As the draft legislation stands, it would appear that if the taxpayer is successful in the tax appeal, he would need to invite HMRC to withdraw the notice, thus disengaging the operation of the penalty provision (and closing down any penalty appeal which is in force).

In practice, it is hoped that where it can, HMRC will refrain from issuing a penalty unless and until it wins the tax appeal. The nature of the penalty is to act as a deterrent against taxpayers maintaining frivolous or unwinnable positions. The mere threat

of it hanging over a litigant's head should be enough to meet this aim.

### Accelerated payment notices

The second weapon in HMRC's proposed arsenal is an 'accelerated payment' notice. This requires the taxpayer to pay the tax in dispute to HMRC pending the outcome of an enquiry or tax appeal. Its application to tax enquiries is the most significant feature of the measure because presently HMRC has no power to require payment without working up an individual case to litigation. Even then, in direct tax cases HMRC in practice postpones payment until it gets a tribunal decision in its favour.

A payment notice may be issued off the back of a follower notice. It may, however, also be issued on a freestanding basis, if the 'chosen tax arrangements' are 'DOTAS arrangements' or a GAAR counteraction notice is or has been given (involving supporting opinions from at least two panel members). The notice will specify HMRC's estimate of the tax due. The taxpayer can make written representations to HMRC that the requisite conditions have not been met, or objecting to the amount of tax payment required.

The taxpayer must make the accelerated payment within 90 days of receipt of the notice or, if written representations are made and the notice is confirmed by HMRC, 30 days from receipt of the confirmation (if this is longer than the original 90 days). A late payment penalty of 5% of the disputed tax is payable if the payment is not made by the deadline, and a further 5% at five and 11 months of the deadline.

The accelerated payment constitutes a payment 'on account of tax'. This means that the sum in question presumably can be enforced as a debt against the taxpayer – including through insolvency action and action to enforce debts via overseas courts where mutual assistance treaties apply. HMRC says it will consider requests for its normal 'time to pay' discretionary relief.

### Challenge

Routes to challenge payment notices are, as with follower notices, limited. There is no right of appeal about the validity of the notice. However, the retrospective nature of the measure may be open to a judicial review challenge on human rights grounds, because the payment notice fundamentally changes the procedural basis on which a pre-existing legal dispute is played out.

It would be difficult to argue that a payment notice based on a follower notice is illegal without also persuading a court that the follower notice itself is invalid. If a court did not overturn HMRC's decision that it is reasonable to conclude that the tax appeal was determined by the 'relevant ruling', it would be difficult to see that a court could say a payment on account of that tax should not be made.

But the merits are stronger where the payment notice is issued only because the arrangements were in DOTAS. Self-evidently, HMRC cannot say it has

already essentially 'won' the tax appeal, because otherwise it would have issued a follower notice.

It may also be possible to challenge a DOTAS based payment notice on the basis that the arrangements were not, in fact, 'notifiable'. This potentially provides an escape route for historic arrangements where, out of an abundance of caution and good citizenship, the promoter notified HMRC even though strictly speaking it did not need to do so.

### Special rules for partnerships

Special rules apply to situations where the dispute is about the partnership's tax return and claims, but where the asserted tax advantage will accrue to the partners. Follower notices are issued to the representative partner. The penalties for non-compliance are lower, with a maximum penalty of 20% for partnerships (as against 50% for others); and a minimum penalty of 4% for partnerships (as against 10% for others). Individual partners are liable for a share of any penalty based on their participation in the profits and losses of the partnership. There is no right of appeal against HMRC's determination of such share.

Accelerated payment notices are replaced with 'partner payment notices', which are issued to the individual partners. The conditions for issuing these are essentially the same, with a modification to reflect the fact that follower notices are given not to the partner but to the partnership. Each partner can make representations about their payment notice, and deadlines for compliance and late payment penalties are the same.

### Pre-existing schemes

Users of existing schemes need to take steps now to analyse how they will be caught by these provisions. HMRC has two years from royal assent in July to issue follower notices in respect of existing 'relevant rulings' (i.e. those given before the legislation is passed). It also has two years to issue payment notices, whether based on a follower notice or the scheme falling within DOTAS. HMRC can issue payment notices based on more than one ground, if relevant.

HMRC has promised to give advance warning of the proposals becoming law in July of the DOTAS schemes upon which it intends to issue payment notices. It also intends to issue warning letters in selected cases. What we do not yet know is whether HMRC will give any advance warning about where it might use follower notices. Clearly, early pointers would be helpful given the added threat of a stiff penalty if the user decides to litigate. We are promised HMRC guidance some time in May, so might have better clarity then.

Taxpayers that expect to be affected by these measures should consider their challenge options. From a timing perspective, the cautious approach would be to wait to bring judicial review proceedings until after a notice has been issued, and to apply for injunctive relief against the enforcement of the

notice. An alternative view is that a challenge could be brought as soon as the measures become law, if it is clear that the taxpayer will certainly be affected – for example, because the taxpayer's scheme is on the published list of schemes HMRC pre-identifies it will be pursuing – and injunctive relief could be sought to stop HMRC from issuing a notice at all.

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In any event, affected taxpayers also ought to be taking steps to 'prepare for the worst' by raising funds to meet expected payment notices, given there is potentially little leeway on 'time to pay'. Such planning should be undertaken on a 'bad luck' assumption of being one of the first to get a notice in HMRC's two year window for getting up to speed.

### Impact on large corporates

Whilst aimed at schemes mass marketed to high net worth individuals, it is worth noting that the measures could also apply to large corporates. The risk of a payment notice may not be of the greatest concern because, although no corporate would welcome having to generate cash to meet a payment notice, the company will have already taken a view for its financial statements on where the cash is likely to sit at the end of the dispute. The main concern will therefore be the risk of a follower notice penalty, if HMRC takes against the efficacy of the planning.

### Tax avoidance in the future

Follower notices and accelerated payment will provide a hefty deterrent against engaging in future schemes. Already, we are seeing signs of changes in behaviour – perhaps most strikingly, one of the most prominent promoters has announced it is pulling out of film schemes – and others may follow suit. However, some promoters are 'adapting', by moving their charges away from upfront mandatory amounts towards back-end fees based on a successful outcome, and marketing ideas which are expressed to fall outside DOTAS (and, of course, the GAAR). But it is already very clear that these proposals will dim the appetite for aggressive avoidance in the future. In terms of existing avoidance disputes, it is disappointing that the government will not offer a carrot with this stick, which would lead to a far quicker settlement of the existing 65,000 cases, and in particular the 22,000 cases which are not caught by these measures. The fear is that, in the short term at least, HMRC has added an extra layer of ground for dispute. ■

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