

Some recent outrageous tax cases

Chasing tax that is not owed

It takes some skill to prosecute a taxpayer for tax he does not owe, and then not only lose the case but find a way for others to avoid tax. Yet that is exactly what HM Revenue and Customs did when they prosecuted Mr Holland all the way to the Supreme Court.

Mr Holland and his wife committed no offence other than to provide a business service to IT consultants. Increasingly, HMRC regard consultants as employees and not self-employed, and demand that the IT companies must operate PAYE and collect class 1 national insurance.

To avoid this, because consultants *are* self-employed, many companies insist that their consultants must be established as a limited company with the consultant as its only employee.

As most IT consultants don't want the bother of filing accounts and corporation tax returns, Mr Holland offered to do it for them. He had 42 such clients and set each one up as a limited company. With the imagination for which accountants are famous, they were known as Paycheck Services 1 Ltd, Paycheck Services 2 Ltd, Paycheck Services 3 Ltd, and so on. Each company had 50 types of non-voting share against which the earnings could be paid as a "dividend".

Mr Holland set up two other limited companies. Paycheck (Directors Services) Ltd and Paycheck (Secretarial Services) Ltd. These were appointed director and company secretary of all 42 companies. These two companies had Mr and Mrs Holland as their directors and shareholders. It is a curiosity of company law that a limited company can itself be a director of another limited company.

The problem then arose under the "associated company" rules for corporation tax. Although these 42 companies related to 42 different people doing 42 different jobs earning 42 incomes, the associated company rules say that companies controlled by the same people are taxed as if they were one company.

Companies pay corporation tax at a lower rate on profits up to £300,000 a year, and at a higher rate above this figure. For the relevant years the lower rate was between 19% and 21%, and the higher rate between 30% and 33%. By adding up all the profits of all 42 companies, the figure of £300,000 was exceeded and so, HMRC argued, higher rate corporation tax was payable.

To avoid the charge, the companies simply paid out their money to the consultants who had earned it. The elaborate scheme failed. However, HMRC received all the tax to which they would have been entitled had the scheme never been set up.

However this was not good enough for HMRC. They pursued Mr Holland personally for the higher rate corporation tax which the companies themselves could not pay as they no longer had any money. This is allowed under insolvency law when a director pays a dividend so large there

is no money left to pay anyone else. The problem is that Mr Holland was not a director of any of these 42 companies. He was a director of a *company* that was a director of these companies.

The arguments go on for 38 pages of legal judgment. They boil down to this question: is a man a director of a company if he is a director of a director of the company? Yes said a High Court judge. No said three judges in the Court of Appeal. Yes said two judges in the House of Lord. No said the other three judges in the House of Lords. (Note how clear the law is.) So that is a no.

HMRC did not get a penny of the tax that was not owed in the first place. And any director who wants to avoid his responsibilities for tax, or for almost anything else, now knows he can do so by becoming a director of another company and making that company a director.

Penalising those who arrange to pay their tax

HM Revenue and Customs is keen that everyone pays their tax. So keen, in fact, that it imposes a penalty when they do, as Houston Cox Interiors Ltd discovered.

Houston Cox and Elvethan Interiors Ltd were owned by the same people. Elvethan made losses, incurred debts and could have been made insolvent. Its main creditor was HMRC who were owed £240,000.

Rather than let Elvethan go bust, the directors decided to use the money in Houston Cox to pay everyone, particularly HMRC. This was arranged by Houston Cox acquiring the business and assets of Elvethan for nil consideration. As Elvethan was now part of Houston Cox, the company deducted the Elvethan loss from Houston Cox's taxable profits.

They could have arranged matters so they did get the tax relief. Houston Cox could have simply assumed responsibility for Elvethan's debts, for example. However they chose to arrange matters differently but for the same broad purpose. They fell foul of an anti-avoidance tax law designed to deny taxpayers relief to which they should be entitled.

Houston Cox could have simply let Elvethan go bust, costing HMRC £240,000. Instead, it acted honourably to make sure the tax was paid, and was penalised for doing so.

Official heartless

What does a government agency do when someone is ill and the victim of crime? When it is HM Revenue and Customs, it imposes heavy penalties. This was the lesson in the case of *Ms AZ. TC 526*.

The anonymous Ms AZ was a massage therapist. In February 2003, she was the victim of a vicious robbery that left her with serious physical and psychological injuries. Her bank cards were stolen and her bank account was systematically emptied and a large overdraft incurred. Before the robbery she had sufficient funds to pay the tax she owed.

The bank with its usual efficiency took two years to sort out the matter.

She became homeless and often could not afford to eat. She was not eligible for state benefits and was told that she was not a priority case for housing. She slept on the floor of her clinic and was helped by friends.

She was suffering from stress and depression that was properly diagnosed as being so serious, she should have stopped working. She continued out of simple necessity. Slowly, after many years, she was able to rebuild her life and career.

HM Revenue and Customs were told of the problems. Their response was to serve 13 penalty notices for late payment of tax. After all, what is someone's first priority when they have been robbed and assaulted, are made homeless, are starving, and suffering from physical and mental injuries? According to HMRC, your first priority is to make sure your tax returns are up to date.

Fortunately the tax tribunal was not so stone-hearted. It dismissed almost all the penalties.

Unsigned demand

If a tax return is not properly signed, it is rejected and the taxpayer can face a penalty. The case of *Ashenford TC 598* shows that the same standards do not apply to HM Revenue and Customs who cannot be expected to get such things right, and incur no penalty when they get it wrong.

Mr Ashenford was guilty of the heinous crime of being four months later in filing a P35 form. This gives details of how much pay, tax and national insurance has been collected through the payroll. There was no suggestion that he had underpaid the tax, paid it late or failed to keep records. His offence was that he was late in sending a form to HMRC. Anyone who deals with the tax authorities knows that being one day late in sending in a form is a heinous offence.

For this, he was charged a fixed penalty of £400.

Let us put this penalty into context. At about the same time, a 17-year old promising athlete called Samantha Sadler from Halton, Cheshire was assaulted by having a brick thrown through her car window. She needed operations for a fractured skull, broken nose and broken eye sockets. She still suffers from double vision. Her athletics career is over.

Her assailant was fined £200. Under English law, being late with a tax return attracts twice the penalty for a serious career-ending violent assault.

The penalty notice was signed by an HMRC officer called Mike Christensen on 3 October 2008.

Mr Ashenford appealed against this ludicrous penalty to a tax tribunal. By coincidence, a member of the panel was Mr Silsby. Christensen had given Silsby a reference to become a member of the panel. Silsby thought that Christensen had retired and asked HMRC to check.

HMRC found that Mike Christensen had indeed retired on 31 August 2008, so he was no longer an HMRC officer when he apparently authorised the penalty notice.

HMRC's reply was that so many penalties are issued, no officer actually bothers to look at them. They are just churned out by the computer without anyone checking anything. HMRC do not even bother to find out whether their own staff have retired.

Under section 100 of Taxes Management Act 1970, a penalty notice must be determined by an officer of HMRC. As Mike Christensen was retired from HMRC when he issued the notice, the notice had not been properly issued. Therefore the tribunal dismissed the penalty without hearing any evidence.

If this penalty notice had not been issued properly, presumably all the other penalty notices issued in that computer run were also invalid. Indeed, as HMRC admits that no officer even bothers to look at the notices, it is arguable that all these penalty notices are invalid. Needless to say, HMRC pays no money to the taxpayer when it gets its paperwork wrong.