FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing

Appeal references: TC/2020/02133
TC/2020/04646

Income tax – determinations for Pay as You Earn income tax – whether determinations made in time – whether loss of income tax brought about carelessly within s36 Taxes Management Act 1970 – no – Penalty – Schedule 24 Finance Act 2007 – whether inaccuracy in document brought about carelessly – no – appeals allowed

Heard on: 3, 4 and 5 May 2023
Judgment date: 1 August 2023

Before

JUDGE ASHLEY GREENBANK
MS CELINE CORRIGAN

Between

MAGIC CARPETS (COMMERCIAL) LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Rebecca Sheldon, counsel, instructed by Tax Innovations Limited

For the Respondents: Sadiya Choudhury, counsel, and Matthew Bignell, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

THE FORM OF HEARING

1. The form of the hearing was V (video) using the Tribunal video hearing system. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

INTRODUCTION

2. These appeals relate to two determinations made pursuant to pursuant to Regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003 (the "**PAYE Regulations**") by the Commissioners for His Majesty's Revenue and Customs ("**HMRC**") and served on the appellant, Magic Carpets (Commercial) Limited ("**Magic Carpets**"), in respect of unpaid PAYE income tax for the tax years 2009/10 and 2010/11 and a related assessment to a penalty under Schedule 24 of the Finance Act 2007 ("**FA 2007**") for the same tax years.

3. The determination for the tax year 2009/10 was issued on 5 April 2016. It was originally in the sum of £236,571.20, but was subsequently revised on review to £105,622.40. The determination for the tax year 2010/11 was issued on 10 February 2017 and is in the sum of £47,088.80. The penalty for the tax years 2009/10 and 2010/11 was assessed in the aggregate sum of £22,221.94. HMRC ask the tribunal to uphold the penalty in the increased sum of £22,906.98 on the grounds that there was a computational error in the calculation of the original assessment.

4. The determinations and the penalty were imposed as a result of Magic Carpets' use of a tax avoidance scheme (the "**Scheme**"), which is described in more detail below, involving contributions made to an employee benefit trust ("**EBT**") and loans to the directors of Magic Carpets. It is common ground that the Scheme did not give rise to the intended tax saving. The only issues in these appeals are:

> (1) whether the determinations were made in time because Magic Carpets and/or a person acting on its behalf carelessly brought about the inaccuracies in its P35 returns for the tax years 2009/10 and 2010/11;
>
> (2) whether Magic Carpets is liable to the penalty on the grounds that there was an inaccuracy in its PAYE return which was brought about carelessly.

5. If the tribunal finds that determinations were made in time and upholds the penalty, Magic Carpets does not dispute the amount of the determinations or the amount of the penalty.

THE EVIDENCE

6. We were provided with an electronic bundle of documents and an electronic bundle of authorities.

7. The bundle of documents included a witness statement served on behalf of HMRC given by Mr Pavel Orehhov, an officer of HMRC, who had worked as part of a project team within HMRC investigating users of the Scheme. He had been the lead case worker for HMRC in relation to these appeals since November 2021.

8. Mr Orehhov gave evidence on the implementation of the Scheme by Magic Carpets and the procedural history of these appeals. He was cross-examined on his statement. For the most part, we have accepted his evidence, although we note that his statement at times strayed into expressions of his personal views on the effect of the documentation or descriptions of events at which he was not present, which we have disregarded.

9. The bundle of documents also included two witness statements served on behalf of the appellant. They were given by Mr Jeremy Holt and Mrs Jacqueline Holt, who were directors of Magic Carpets at all material times, and who were the beneficiaries of the payments from the EBT to which we refer below.

10. Mr and Mrs Holt were both cross-examined on their statements. They were straightforward witnesses. We found them both to be honest and candid. They readily accepted the failings in the implementation of the Scheme and were open about circumstances in which they could not be confident of their recollections of events. There were material details that they simply could not recall. We found this understandable given the time that has elapsed since the events on which they were being asked to give evidence.

11. In the course of the hearing, after the tribunal had heard evidence from some of the witnesses, Ms Sheldon made an oral application to introduce new evidence, namely copies of Mr and Mrs Holt's tax returns, for relevant periods. Having heard submissions from the parties, we rejected that application on the grounds that it would not have been in accordance with the overriding objective (in rule 2 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 ("**FTR**")) to admit the evidence at that stage: the application was made at too late a stage in the proceedings; certain witnesses had already given evidence and would have to be recalled; and, in any event, in our view, the evidence would not have added materially to evidence before the tribunal on the issues that were before it.

THE SCHEME

12. It will help our explanation if we first set out the steps in the Scheme. Subject to some minor amendments, we have taken this description largely from Ms Choudhury's skeleton argument, but we did not understand there to be any dispute between the parties about it.

13. The Scheme was created and marketed by Clavis Tax Solutions Limited ("**Clavis**").

14. In outline, the Scheme involved the following steps.

(1) Herald Employment and Recruitment Services Limited, trading as "Herald Resource" ("**Herald**") was a Jersey human resources company. Herald would offer a taxpayer company a service in the form of a review for the purpose of making recommendations as to how key employees, such as the company's directors, ought to be rewarded and incentivized. Herald would then outsource the performance of the review service to Herald Employment Services LLP ("**HES**"), a UK limited liability partnership whose members included the directors of Clavis.

(2) The findings of the review formed the basis of recommendations made by Herald in a report, which would detail various methods of reward such as payment of a dividend or bonus. However, Herald would invariably recommend that rewards be provided by the company settling an amount equal to that which the review had found would reward and incentivize the directors into an offshore EBT from which the directors could benefit. The trustee of the EBT was Herald Trustees Limited ("**Herald Trustees**"), whose directors were the same as Herald's directors.

(3) Herald would send an invoice at the same time as the report for an amount that included both its fees for implementing the recommendation and the sum it had recommended be made available to the employees. In order to implement that recommendation, the company would pay the invoice to Herald. Clavis and Herald would deduct their fees (being in aggregate approximately 10% of the total sum paid by the company) from this sum, and the balance would be settled on the EBT in the company's name.

(4) A sub-trust of the EBT would be set up for each employee who was to benefit from the arrangements to which a share of the amount contributed to the EBT would be allocated. The funds in the sub-trust would then be used to benefit the employee by making loans. The company would later claim a corporation tax deduction for the payment it had made under the invoice on the grounds that it constituted fees for Clavis and Herald even though it was included in its accounts as remuneration. It would not account for PAYE income tax or national insurance contributions ("**NICs**") in respect of any loans provided to employees by the EBT out of the contribution.

15. The intended effect of the Scheme, and the basis on which it was marketed, was that the loans made to the employees by the sub-trust did not attract a liability to PAYE income tax and NICs for the employer, but that the employer company was entitled to a deduction for corporation tax purposes for the payment made to Herald for the report and the implementation of the proposals. We will address some of the tax analysis in more detail later in this decision, but, in summary, the Scheme sought to circumvent a restriction introduced in Schedule 24 to the Finance Act 2003, and later re-enacted as sections 1290 to 1296 of the Corporation Tax Act 2009 ("**CTA 2009**"), which denied a corporation tax deduction for "employee benefit contributions" made by an employer company (which included contributions made to an EBT) until such time as the contributions were applied to benefit an employee and PAYE income tax and NICs became payable in respect of them. It did so relying on an exception (in section 1290(4)(a) CTA 2009) for payments representing "consideration for goods or services provided in the course of a trade or profession".

16. The Scheme also relied upon the loans made by the sub-trusts to the employees not being immediately subject to tax as earnings of the employees. Some time after the implementation of the Scheme by Magic Carpets in this case, HMRC was successful in establishing that amounts contributed to an EBT for the purposes of remunerating employees should be treated as earnings of the relevant employees (see the decision of the Supreme Court in *RFC 2012 Plc (in liquidation) (formerly the Rangers Football Club Plc) v Advocate General for Scotland* [2017] UKSC 45 ("***Rangers***")). However, before the decision in *Rangers*, the courts and tribunals had reached differing views on this point.

17. As we have mentioned, we will address some of these issues later in this decision. We will also address the status of the law at the time of the implementation of the Scheme by Magic Carpets. However, it is sufficient for present purposes to note that it is no part of Magic Carpets' case that the Scheme was successful in meeting its intended aims.

FINDINGS OF FACT

18. We will first set out our findings of fact in this case. For the most part the facts are not contentious, and we can state them simply. However, there are a few areas in which the evidence has been challenged and, in those instances, we will aim to give our reasons for the findings that we have made.

Background

19. Magic Carpets carries on a floor and wall covering business providing carpets and flooring services based in Salisbury. It was established as a limited company in 1999. The directors of the company are, and at all material times were, Mr and Mrs Holt.

20. For the periods in question, the company's accountants were Buckley & Co., Chartered Accountants ("**Buckleys**"), who were represented by Mr Philip Buckley and Mr Peter Pring. Buckleys had been recommended to Mr and Mrs Holt by friends and business associates. Mr and Mrs Holt trusted Buckleys implicitly with the company's accounting and tax affairs.

21. Buckleys were part of the Probiz network of accountants which Clavis used to market the Scheme. Buckleys received commissions from Probiz and Clavis for introducing clients to the Scheme.

The advice relating to the Scheme

22. Mr Buckley held annual meetings with the directors, Mr and Mrs Holt, shortly before the end of the company's financial year, which was 31 March. In those meetings, which would last about 45 minutes, Mr Buckley provided advice on the accounts and on tax matters.

23. The Scheme was first recommended to Mr and Mrs Holt by Mr Buckley in such a meeting in March 2009. The only advice that the company received on the steps in the Scheme and the tax consequences of the Scheme was in that brief conversation between Mr Buckley and Mr and Mrs Holt towards the end of March 2009.

24. Mr and Mrs Holt were told by Buckleys that several of Buckleys' clients were using the Scheme and that Buckleys themselves used the Scheme.

25. It is also Mr and Mrs Holt's evidence that they were told by Buckleys that the Scheme was supported by an opinion of leading tax counsel. In their evidence, both Mr Holt and Mrs Holt referred to an opinion from Robert Venables QC. There is no evidence that Robert Venables QC gave an opinion on the Scheme and Ms Choudhury challenged Mr and Mrs Holt's evidence on this point. It may well be that Mr and Mrs Holt's recollection as to which counsel had given an opinion in relation to the Scheme was not accurate. However, the critical point is that they were told that the Scheme was supported by an opinion of leading counsel. We accept that evidence and find as a fact that this is what they were told.

26. Mr and Mrs Holt also say in their evidence that they were told by Buckleys that the Scheme had been approved by HMRC. Ms Choudhury took both Mr Holt and Mrs Holt to a letter of engagement from Clavis to the company dated 6 November 2009. The letter clearly stated that "it cannot be guaranteed that HM Revenue & Customs will accept the technical analysis and consequences of the arrangements" and later in the same document that "we have explained to Probiz Midlands, and they have acknowledged that the arrangements are not approved by any government body or fiscal authority including HM Revenue & Customs. Further, we understand that the Probiz Accountant has made you fully aware of this." The letter is countersigned by Mr Holt on 10 November 2009 to acknowledge receipt of the letter.

27. Mr Holt accepted that he received the letter, but says that he did not read it. Mrs Holt could not recall the letter. Both Mr and Mrs Holt said that they trusted their accountants, Buckleys, when they said that the Scheme was approved by HMRC. We accept their evidence and find as a fact that they were told by Buckleys that the Scheme was approved by HMRC and that, notwithstanding the letter of engagement that they had received from Clavis to the contrary, they trusted Buckleys that this was the case. They made no further enquiry to verify whether or not the Scheme was approved by HMRC.

28. The letter of engagement from Clavis also expressly stated that Clavis was not providing any tax advice. Mr and Mrs Holt did not at any time ask Buckleys for any written advice in relation to the Scheme. They did not seek a copy of the advice from leading counsel. They did not seek a second opinion on the efficacy of the Scheme from another tax adviser.

29. As we have described above, the only advice that the company received on the steps in the Scheme and its tax consequences was in the conversation with Mr Buckley in March 2009. Mr and Mrs Holt admit that that advice was "brief" and "rushed". It was clear from their evidence that Mr and Mrs Holt understood little of the steps in the Scheme – other than it involved an EBT and loans to them – or of the tax implications of the Scheme – other than that it was "tax planning" that would save them and company tax. Buckleys did not explain any of

the risks involved in the Scheme. Mr and Mrs Holt trusted Buckleys, as the company's accountants, implicitly, and took the steps that they were told to take by Mr Buckley and Mr Pring.

Magic Carpets' implementation of the Scheme

30. Magic Carpets used the Scheme twice, once in the tax year 2009/10 and once in the tax year 2010/11.

31. We set out the details of the implementation of the Scheme in both tax years below.

The first tranche: 2009/10

32. In relation to the 2009/10 tax year:

(1) The documents include the minutes of a meeting of Magic Carpets' board of directors, dated 26 March 2009. The minutes record: that the meeting was attended by the directors and Mr Buckley; that arrangements for rewarding employees were considered; and that the directors were selected as potentially suitable persons for reward. The amount to be allocated to the directors was left blank. The minutes were signed by Mr Holt as Chairman.

(2) Clavis sent an email to Mr Pring attaching 23 documents which formed the documentation for the Scheme on 27 October 2009. Clavis re-sent the email on 3 November 2009. The documents included a letter of engagement between Clavis and Magic Carpets, draft minutes of board meetings, a Herald service agreement for sub-trusts, and draft loan applications and loan agreements. The documentation also included an outsourcing agreement between Herald and Magic Carpets, pursuant to which Herald agreed to provide human resources services to Magic Carpets including (a) evaluating the duties of employees specified by the company, (b) conducting interviews with those employees, (c) producing a report for the company recommending the types of benefits to be provided and the approximate costs, (d) proposing an overall fee covering the benefits to be provided as well as Herald's costs and (e) implementing the agreed proposals.

(3) On 4 or 5 November 2009, Mr Pring met Mr and Mrs Holt. Mr and Mrs Holt signed the documents that required their signatures (either personally or on behalf of the company). The documentation included minutes of meetings of the board of directors of Magic Carpets to establish an employment committee and to accept the outsourcing agreement. The documents were left undated and subsequently dated by Buckeys or Clavis. Mr and Mrs Holt also provided information to Mr Pring to enable him to complete a questionnaire covering the business of the company, their roles in the company and confirming that they wished to be remunerated through the provision of interest-free loans.

(4) On 5 November 2009, Mr Pring wrote to Clavis enclosing the completed documentation and the completed questionnaire.

(5) On 6 November 2009, Clavis sent the engagement letter, to which we refer above, to Mr Holt as chair of the employment committee of the company.

(6) On 10 November 2009, HES sent a letter to Herald referring to a meeting with Magic Carpets. The letter stated that HES considered that a benefit and incentive budget of approximately £305,000 to £335,000 should be able to provide a sufficient level of benefits and incentives to motivate, reward and retain the employees.

(7) The documentation contains minutes of meeting of the company dated 10 November 2009 establishing an employment committee comprising Mr and Mrs Holt.

The minutes were signed by Mr Holt on 4 or 5 November 2009 but were later dated by Mr Pring.

(8) Herald prepared a report dated 13 November 2009 which included an evaluation of the directors' performance and recommendations as to how they should be rewarded and incentivized. Other than standard information on forms of remuneration and benefits, the information in the report is taken from the questionnaire. In the report, Herald recommended that each of the directors should be provided with benefits with a value between £150,000 and £170,000 either in the form of cash bonuses or through the use of a special purpose trust. An overall benefit and incentive budget of £350,000 was recommended.

(9) Herald issued an invoice for £350,000 to Magic Carpets on the same day. The minutes of a meeting of the Magic Carpets' employment committee, dated 16 November 2009, record that the content of the report was discussed, and it was resolved to settle the invoice. Magic Carpets paid £190,000 to Herald on 25 November 2009. The sum of £170,270.28 was then settled on The Magic Carpets (Commercial) Limited Settlement (the "**MC EBT**"). The trustee of the MC EBT was Herald Trustees and the beneficiaries included Magic Carpets' employees and officers.

(10) Herald Trustees, as trustee, allocated the sum of £170,270.28 to the Jeremy & Jacqueline Holt Sub-Trust No.1 (the "Sub-Trust") for the benefit of Mr and Mrs Holt on 30 November 2009. On 2 December 2009, Mr and Mrs Holt received interest-free loans in the aggregate amount of £163,575.28 from the Sub-Trust.

(11) On 14 December 2009, Magic Carpets paid the balance of the invoice in the sum of £160,000 to Herald. A proportion of this sum was then settled on the MC EBT. On 16 December 2009, Herald Trustees, as trustee of the MC EBT, allocated the sum of £144,144.14 to the Sub-Trust for the benefit of Mr and Mrs Holt. Mr and Mrs Holt received interest-free loans in the aggregate amount of £143,449.14 from the Sub-Trust on 18 December 2009.

The second tranche: 2010/11

33. In relation to the 2010/11 tax year:

(1) The documents include the minutes of a meeting of Magic Carpets' board of directors, dated 30 March 2010. The minutes record: that the meeting was attended by the directors; that arrangements for rewarding employees were considered; that the sum of £175,000 was set aside for remunerating employees for the year ended 31 March 2010; and that the directors were selected as potentially suitable persons for reward. The minutes were signed by Mr Holt as Chairman.

(2) Mr Pring sent a letter to Clavis enclosing the completed sign-up documentation from Magic Carpets on 1 April 2010.

(3) Herald prepared a report dated 13 April 2010. This report was in similar form to the report dated 13 November 2009 save that the recommendations were for each of the directors to receive an amount of £70,000 to £90,000 within an overall benefit and incentive budget of £175,000. Herald issued an invoice for £175,000 to Magic Carpets on 13 April 2010.

(4) The documents include minutes of a meeting of the employment committee of Magic Carpets dated 21 April 2010, which record that the content of the report was discussed, and that it was resolved to settle the invoice. Magic Carpets paid £175,000 to Herald on 22 April 2010. A proportion of this sum was then settled on the MBC EBT.

(5) On 26 April 2010, Herald Trustees, as trustee, allocated the sum of £156,657 to the Sub-Trust for the benefit of Mr and Mrs Holt. On 27 April 2010, Mr and Mrs Holt received interest-free loans in the aggregate amount of £156,062 from the Sub-Trust.

Specific factual issues regarding the implementation of the Scheme

34. In our description above, we have recorded the steps in the Scheme as reflected in the documents that have been provided to the tribunal. We should address at this stage our findings on various issues relating to the documentary evidence that have been raised by HMRC.

35. In both tax years, much of the documentation to which the company and the directors were parties was signed at meetings with Mr Pring. Mr Pring would produce the relevant paperwork for Mr and Mrs Holt to sign. He did not provide any advice. He simply collected the signatures on the documents that would be left undated and with various details left blank. Those dates and details would then be completed (to the extent that they were completed at all) by Buckleys or Clavis.

36. Mr and Mrs Holt's evidence on the effect of the documentation was limited. Mr Holt was more familiar with some of the documentation. Mrs Holt was unable to recall much of the paperwork. We accept this was partly due to the effluxion of time. However, it is clear to us that Mr and Mrs Holt, even if they did read some of the paperwork, did not engage with it. They recognized that the Scheme as a "tax planning scheme" and trusted Buckleys to deal with the paperwork. As Mr Holt is quoted as saying in the ADR exit document, they regarded the Scheme as "a paper exercise" designed to reduce the tax liabilities of the company and its directors. Beyond an appreciation that the Scheme involved a contribution to an EBT and loans to them, Mr and Mrs Holt did not understand the steps in the Scheme or make any real attempt to do so.

37. HMRC do not submit that the implementation of the Scheme was entirely a "sham". HMRC accept that the MC EBT was established and that payments were made on the relevant dates. HMRC do, however, assert that in some respects the documentary evidence does not reflect the underlying facts.

(1) First, it is HMRC's case that the meetings of the board of Magic Carpets or the employment committee of the board for which signed minutes are provided in the documentation did not take place on the dates set out in the minutes or at all.

(a) As regards the meeting of the board for which minutes are provided dated 26 March 2009. Given that it was not the usual practice of the company to prepare minutes for directors' meetings, the minutes represent an overly formal representation of the proceedings, however, we infer that 26 March 2009 was the date of Mr Buckley's initial meeting with Mr and Mrs Holt at which he first introduced them to the Scheme. At that meeting, Mr and Mrs Holt, as directors, took the decision to enter into the Scheme for the tax year 2009/10. However, given that no further steps in the Scheme took place until much later in the year, we also infer that the amount that was to be made available to the directors under the arrangements was not fixed at that time. It was agreed that an amount equal to what would otherwise have been the accounting profit would be made available to the directors under the Scheme. The figure of £350,000 used for the basis of the remuneration provided to the directors was determined at a later date once what would otherwise have been the accounting profit had been established.

(b) As regards the meeting for which minutes are provided dated 30 March 2010, although the minutes are perhaps again an overly formal representation of the

proceedings, we find that a decision was taken by the directors on that day to implement the Scheme for tax year 2010/11.

(c) As regards, the other meetings of the board and its employment committee reflected in the documentation, we agree with HMRC that the relevant meetings did not take place on the dates recorded in the documents and that they did not take place in the form of formal board meetings. As we have described, the documents were all signed in advance by Mr and Mrs Holt and the dates in them inserted at a later stage by Clavis or Buckleys. However, that does not mean that Magic Carpets did not enter into the transactions reflected in the documents. Acting through its two directors, Mr and Mrs Holt, Magic Carpets entered into the engagement letter with Clavis, agreed to make the payments to Herald and made those payments. At some point, whether through formal board meetings or otherwise, the directors made collective decisions to enter into the transactions to which the company became a party.

(2) HMRC also say that the remuneration review provided by Herald had no substance. There was a written report for each relevant tax year provided by Herald. As we have described, the bulk of the report contained standard information on forms of remuneration and benefits. As regards the parts of the report that addressed the specific circumstances of Magic Carpets, contrary to the impression given by some of the documents, neither HES nor Herald held any meetings with Magic Carpets or its directors at any stage. The information on which the report was based was contained in the responses to the questionnaire provided by Mr and Mrs Holt to Mr Pring.

(3) HMRC also say that there is no evidence that the payments made to Mr and Mrs Holt by the Sub-Trust were loans and not outright payments. HMRC point to the fact that the loan agreements and applications for loans that are included in the documentation are not dated and do not include the amounts that were advanced to Mr and Mr Holt. They also refer to various statements made by Mr and Mrs Holt in cross-examination to the effect that they expected that the monies would be paid to them and their lack of clarity about the terms on which the funds were advanced.

On this point, we do not agree with HMRC. There is ample evidence that the payments were loans. The payments are identified as loans in the bank statements and the existence of the loan agreements and applications supports that conclusion. Mr Holt's recollection, which we accept, was that the funds were to be repaid "at some point" and that "annual fees" – which we take to be a reference to income tax charges on the benefit of the interest-free loans – were paid in respect of them. We find as a fact that the payments made by the Sub-Trust to Mr and Mrs Holt were loans.

Reporting of the transactions

38. It was common ground that Magic Carpets did not account for PAYE income tax or NICs on the amounts paid into the Sub-Trust and advanced to the directors as loans for the tax years 2009/10 and 2010/11.

39. It was also common ground that the loans were not included in the P35 returns for those years, and that they were filed by Buckleys on behalf of the company. We have accepted that position. However, we should record that the P35 returns for the tax years 2009/10 and 2010/11 were not included in the documents before the tribunal. We have also proceeded on the basis that the P35 returns were filed on time – that is, before 19 May 2010 for the tax year 2009/10 and before 19 May 2011 for the tax year 2010/11. That would appear to have been the common assumption of the parties. We have proceeded on that basis, although we have not seen any evidence to that effect.

40. In its accounts for the period ended 31 March 2010, the "trading and profit and loss account" includes a figure of £136,500 as "directors' salaries" for the period ended 31 March 2010 and a figure of £338,500 as "directors' salaries" for the period ended 31 March 2009. The relevant note to those entries refers to a sum of £175,000 paid as directors' remuneration. The relevant note was in following form.

> Directors' Remuneration includes the amount of £175,000 in respect of sums payable to a human resources company to develop and implement a remuneration plan for the purposes of rewarding key employees of the company for their performance over a specified period, which will·include a payment into an employee benefit trust of £156,757 by the HR Company.

This would appear to be a reference to the payment made to Herald to fund the interest-free loans made to the directors in the 2010/11 tax year.

41. The corporation tax return of the company for the period ended 31 March 2010 makes no specific reference to that payment, but the net trading profit as shown in the accounts is only £13,723. The note to the accounts, however, refers to the payment as included in directors' remuneration which is taken into account in computing (and so reducing) the trading profit as shown in the accounts. The accounts were provided to HMRC with the corporation tax return. We therefore infer that a deduction was claimed for the amount of the payment.

42. We were not provided with the accounts for the period ended 31 March 2009 or the corporation tax return for that period.

The determinations and penalty

43. On 5 April 2016, HMRC issued a determination pursuant to Regulation 80 of the PAYE Regulations for the tax year 2009/10 in the amount of £236,571.20 in respect of the contribution made by Magic Carpets to the MC EBT and allocated to the Sub-Trust in that year. Magic Carpets appealed the determination to HMRC on 3 May 2016.

44. On 10 February 2017, HMRC issued a determination pursuant to Regulation 80 of the PAYE Regulations for the tax year 2010/11 in the amount of £47,088.80 in respect of the contribution made by Magic Carpets to the MC EBT and allocated to the Sub-Trust in that year. Magic Carpets appealed the determination to HMRC on 28 February 2017.

45. In or around October 2019, Magic Carpets brought proceedings in the High Court against Buckleys alleging professional negligence as regards their failure properly to evaluate and advise on the Scheme. Magic Carpets reached an out of court settlement with Buckleys.

46. On 20 January 2020, Magic Carpets requested an independent review of the determinations. The conclusions of the review were notified to Magic Carpets in a letter dated 26 May 2020. The review concluded that the determinations had been validly raised but the amount assessed by the determination for the tax year 2009/10 was reduced to £105,622.40.

47. Magic Carpets notified its appeals against the determinations to the Tribunal on 25 June 2020.

48. Following the notification of the appeals to the Tribunal, the parties entered into an ADR process in an attempt to resolve the dispute. The ADR process ended without resolution on 16 November 2020.

49. On 5 December 2020, HMRC issued a notice of penalty assessment to Magic Carpets under Schedule 24 FA 20007 in the total sum of £22,221.24 comprising (a) a penalty of £15,843.36 for the tax year 2009/10 and (b) a penalty of £6,377.88 for the tax year 2010/11. The penalty was assessed on the grounds that there were inaccuracies in the company's PAYE returns which were careless.

50. Magic Carpets appealed to HMRC against the penalty notice on 17 December 2020. On 18 December 2020, Magic Carpets notified its appeal against the penalty to the Tribunal.

51. HMRC now say that there was a computational error in the calculation of the original assessment and that the correct amount of the penalty is £22,906.98. Magic Carpets does not dispute the amount of the penalty if HMRC succeeds is showing that determinations were validly made, and that the inaccuracies were careless.

THE RELEVANT LEGISLATION

52. As we have described, there are two issues before the Tribunal on this appeal. The first is whether the determinations were made in time. The second is whether Magic Carpets is liable to a penalty for having provided an inaccurate document to HMRC. We have set out below the relevant legislation that applies to these issues.

The time limit for making the determinations

53. Regulation 80 of the PAYE Regulations applies where HMRC make a determination in respect of unpaid PAYE income tax.

54. For the tax year 2009/10, Regulation 80 of the PAYE Regulations provided, so far as relevant:

> **80.— Determination of unpaid tax and appeal against determination**
>
> (1) This regulation applies if it appears to HMRC that there may be tax payable for a tax year under regulation 68 by an employer which has neither been–
>
> (a) paid to the Inland Revenue, nor
>
> (b) certified by the Inland Revenue under regulation 76, 77, 78 or 79.
>
> (2) HMRC may determine the amount of that tax to the best of their judgment, and serve notice of their determination on the employer.
>
> …
>
> (5) A determination under this regulation is subject to Parts 4, 5 and 6 of TMA (assessment, appeals, collection and recovery) as if–
>
> (a) the determination were an assessment, and
>
> (b) the amount of tax determined were income tax charged on the employer,
>
> and those Parts of that Act apply accordingly with any necessary modifications.

55. Regulation 80 was in similar form in the tax year 2010/11 except that Regulation 80(5) included a reference to Part 5A of the Taxes Management Act 1970 ("**TMA**") in addition to Parts 4, 5 and 6 of TMA.

56. As can be seen from the extract that we have quoted above, under Regulation 80(5), certain provisions of TMA which apply to assessments to income tax, also apply to determinations under Regulation 80. Those provisions include Part 4 of TMA, which contains the time limits for the making of an assessment to income tax. By virtue of Regulation 80(5), the same time limits apply to the making of a determination under Regulation 80 for unpaid PAYE income tax.

57. Under section 34 TMA, the ordinary time limit for HMRC to make an assessment to income tax is 4 years after the end of the year of assessment to which it relates. The determinations in this case were not made within that time limit. However, section 36 TMA

provides for an extended time limit where the loss of tax is brought about carelessly by a person or by another person acting on behalf of that person.

58. Section 36 TMA provides, so far as relevant:

> **36.— Loss of tax brought about carelessly or deliberately etc.**
>
> (1) An assessment on a person in a case involving a loss of income tax or capital gains tax brought about carelessly by the person may be made at any time not more than 6 years after the end of the year of assessment to which it relates (subject to subsection (1A) and any other provision of the Taxes Acts allowing a longer period).
>
> …
>
> (1B) In subsections (1) and (1A) references to a loss brought about by the person who is the subject of the assessment include a loss brought about by another person acting on behalf of that person.

59. Section 36 therefore extends the time limit for making an assessment to 6 years after the end of the year of assessment to which it relates where the loss of tax is brought about carelessly by a person or by another person acting on behalf of that person. The determinations that are the subject of this appeal were made within that six-year time limit.

60. The references in subsections (1) and (1B) of section 36 to subsection (1A) are to cases where a loss of tax is brought about deliberately. It is no part of HMRC's case that the loss of tax in this case was brought about deliberately by Magic Carpets.

61. Section 118(5) TMA sets out circumstances in which a loss of tax will be regarded as brought about carelessly. It provides:

> (5) For the purposes of this Act a loss of tax or a situation is brought about carelessly by a person if the person fails to take reasonable care to avoid bringing about that loss or situation.

The imposition of penalties

62. The legislation governing the imposition of penalties for inaccuracies in documents provided to HMRC is found in Schedule 24 FA 2007. Paragraph 1 Schedule 24 FA 2007 provides:

> **1 Error in taxpayer's document**
>
> (1) A penalty is payable by a person (P) where–
>
> (a) P gives HMRC a document of a kind listed in the Table below, and
>
> (b) Conditions 1 and 2 are satisfied.
>
> (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to–
>
> (a) an understatement of a liability to tax,
>
> (b) a false or inflated statement of a loss, or
>
> (c) a false or inflated claim to repayment of tax.
>
> (3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.
>
> …

63. Subparagraph (4) contains the Table that is referred to in subparagraph (1). A return for the purposes of the PAYE Regulations is one of the documents listed in the Table.

64. Paragraph 3 of Schedule 24 FA 2007 contains the definition of "careless" for these purposes. It provides, so far as relevant:

> **3 Degrees of culpability**
>
> (1) For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is–
>
> (a) "careless" if the inaccuracy is due to failure by P to take reasonable care,
>
> …

65. There are various provisions in Schedule 24 FA 2007 that address the quantum of any penalty and the factors that can be taken into account in mitigating it. However, those provisions are not in issue in this appeal.

66. Paragraph 18 of Schedule 24 FA 2007 deals with agents. The relevant provisions of paragraph 18 are subparagraphs (1) and (4). They are in the following form:

> **18 Agency**
>
> (1) P is liable under paragraph 1(1)(a) where a document which contains a careless inaccuracy (within the meaning of paragraph 3) is given to HMRC on P's behalf.
>
> …
>
> (4) In paragraph 3(1)(a) (whether in its application to a document given by P or, by virtue of sub-paragraph (1) above, in its application to a document given on P's behalf) a reference to P includes a reference to a person who acts on P's behalf in relation to tax.

RELEVANT CASE LAW ON THE MEANING OF "CARELESS" AND "CARELESSLY"

67. As can be seen from the legislation that we have just described, the issues that are before the tribunal turn on whether or not Magic Carpets (or a person acting on its behalf) was careless or acted carelessly, and, in both cases, this is tested by reference to whether or not a person fails to take reasonable care (see section 118(5) TMA and paragraph 3(1)(a) Schedule 24 FA 2007).

68. There was no disagreement between the parties as to how this test should be applied. Both parties referred us the decision of the Upper Tribunal (Morgan J and Judge Brannan) in *Hicks v HMRC* [2020] UKUT 0012 (TCC) ("***Hicks***") and, in particular, to the passage in the decision where the Upper Tribunal makes it clear that for this purpose the taxpayer's conduct has to be assessed by reference to a prudent and reasonable taxpayer in his or her position. The Upper Tribunal says this (*Hicks* [120]):

> Whether acts or omissions are careless involves a factual assessment having regard to all the relevant circumstances of the case. There are many decided cases as to what amounts to carelessness in relation to the completion of a self-assessment tax return. The cases indicate that the conduct of the individual taxpayer is to be assessed by reference to a prudent and reasonable taxpayer in his position: see, for example, *Atherton v HMRC* [2019] UKUT 41 (TCC), [2019] STC 575 (Fancourt J and Judge Scott) at [37].

69. The decision in *Hicks* related to an income tax self-assessment, but the parties agree that the test as articulated in that case applies equally to a determination under the PAYE Regulations. The parties also agree that the same test applies for the purpose of both section 36 TMA and paragraph 3 Schedule 24 FA 2007 (see *Collis v HMRC* [2011] UKUT 588 (TC) at [29]).

CASE LAW RELATING TO LOAN SCHEMES

70. The other matter that we should address by way of background is the status of the case law authorities relating to tax avoidance schemes involving loans at the time at which Magic Carpets entered into the Scheme.

71. As we have mentioned above, the Supreme Court decided in *Rangers* in 2017 that payments made by a company to an EBT for the purpose of providing remuneration in the form of loans to employees should be treated as earnings of the relevant employees so that PAYE income tax and NICs became due immediately. However, before that time, the courts and tribunals had reached differing views on the treatment of tax avoidance schemes involving EBTs and provision of remuneration to employees in the form of loans.

72. In particular, prior to the Court of Session decision in *Murray Group Holdings Ltd and others v HMRC* [2016] STC 468 ("***Murray Group***") (subsequently upheld in *Rangers*), HMRC had not succeeded in arguing that such arrangements gave rise to an income tax charge. The leading reported decisions at the time at which Magic Carpets participated in the Scheme, were the Special Commissioners in *Dextra Accessories Ltd & Ors v Macdonald (Inspector of Taxes)* [2002] STC (SCD) 413 ("***Dextra***") and *Sempra Metals Ltd v HMRC* [2008] STC (SCD) 1062. In both of those cases, the Special Commissioners had found that income tax was not due on the loans. (The decisions in both of those cases also concerned the availability and timing of any deduction from profit for corporation tax purposes for payments made to an EBT. *Dextra* proceeded to the House of Lords on that point. However, the PAYE income tax treatment of the contributions to the EBT and loans to the employees was not in issue before the higher courts.)

73. On the question of the status of the case law authorities at the time at which Magic Carpets entered into the Scheme, Ms Sheldon referred us to the Independent Loan Charge Review dated December 2019. The Independent Loan Charge Review was a review commissioned by the Chancellor of the Exchequer in September 2019 into the introduction of legislation, in Schedule 11 to the Finance (No.2) Act 2017, to address schemes involving EBTs and provision of remuneration to employees in the form of loans. That legislation imposed a charge to income tax on the balance of all loans made pursuant to such schemes on or after 6 April 1999, which remained outstanding on 5 April 2019 (the "**loan charge**"). The Independent Loan Charge Review recommended various changes to the legislation, including, given widespread concerns about the retrospective nature of the loan charge, an amendment to restrict the loan charge to loans made on or after 9 December 2010. This proposal was adopted and a change to the legislation was made in section 15 Finance Act 2020.

74. The Independent Loan Charge Review identified 9 December 2010 as an appropriate date for the commencement of the loan charge regime by reference to the introduction in the Finance Act 2011 of legislation – referred to as the "disguised remuneration rules" (which became Part 7A of the Income Tax (Earnings and Pensions) Act 2003) – which imposed an income tax charge on the full value of a loan made to an employee by an EBT. The legislation took effect from the start of the tax year 2011/12. However, anti-forestalling rules included in the legislation applied from 9 December 2010 as that was the date on which the legislation was published in draft and a ministerial statement was made in Parliament. In the view of the Review, that was the point at which taxpayers should have been aware that a tax charge would arise on loans made to employees through a third party such as an EBT (see Independent Loan Charge Review paragraph 4.14). Before that date, given the decided cases at the time, taxpayers were entitled to assume that loans from an EBT were not subject to income tax.

75. We should record that Ms Choudhury objected to reliance on Independent Loan Charge Review. However, we have rejected Ms Choudhury's objections. It seems to us that the

Independent Loan Charge Review provides a useful summary of the history of the status of the case law and the legislative response to these schemes over time and it is in the interest of the overriding objective to deal with cases fairly and justly (FTR rule 2) to permit reference to it. If and to the extent that we need to do so, we admit the Independent Loan Charge Review as evidence in accordance with the powers of the Tribunal under FTR rule 15.

THE ACTIONS OF THE COMPANY

76. We will address the issues in relation to Magic Carpets itself before we turn to the actions of Buckleys on its behalf.

The parties' submissions

77. Ms Choudhury says that it is clear that Magic Carpets acted carelessly.

(1) There was a loss of tax. Magic Carpets failed to account for PAYE income tax in respect of monies contributed to the MC EBT and allocated to the Sub-Trust.

(2) It was accepted that the P35 returns did not include the amounts of the loans and so were inaccurate.

(3) Magic Carpets proceeded with the Scheme with little or no understanding of the steps and without seeking adequate or appropriate advice on its effectiveness and proper implementation. On their own evidence: Mr and Mrs Holt did not understand the operation of the Scheme; they did not receive or seek out any detailed advice about the effectiveness of the Scheme or its implementation; and they failed to make any enquiries into the basic commerciality of the steps in the Scheme.

(4) There were numerous errors in the implementation of the Scheme: documents were left undated and incomplete; the directors executed documents that referred to meetings that did not take place.

(5) There was no substance to the arrangements with Herald for the provision of a review of the employee remuneration. On Magic Carpets' own evidence the arrangements were a "paper exercise". There was no real service provided by Herald. Herald did not undertake an independent review of the company's remuneration arrangements. Herald's reports simply recommended the figures provided to it by Mr and Mrs Holt.

(6) A prudent and reasonable taxpayer would have questioned paperwork which did not accurately reflect the actions that had taken place and would have carried out their own basic due diligence on the steps in the Scheme. In the circumstances, a prudent and reasonable taxpayer would also have sought independent professional advice on the effectiveness and proper implementation of the Scheme before submitting (or authorizing Buckleys to submit) P35 returns which did not include the amounts of the loans.

78. Ms Sheldon, for Magic Carpets, makes the following points.

(1) Magic Carpets was not careless. Mr and Mrs Holt were advised by Buckleys, their independent advisers, that the tax planning worked and had HMRC's approval. They were told by Buckleys that they were carrying out the planning themselves. They were advised that the Scheme was supported by an opinion of leading counsel. In those circumstances, the company was not careless. A prudent and reasonable taxpayer in its position would rely upon advice provided by their professional advisers.

(2) It is clear from the wording of section 36 TMA that, for the six-year time limit to apply, the loss of PAYE income tax must itself be brought about carelessly. The same causal link is present in paragraph 3 of Schedule 24 FA 2007 which requires that the

relevant inaccuracy must be due to a failure to take reasonable care. The status of the case law authorities at the time at which the company entered into the Scheme suggested that PAYE income tax was not due. It was not careless to rely upon that position for the purposes of tax planning.

(3) Even if the company was careless in the manner in which it implemented the Scheme, that carelessness did not cause a loss of tax or any inaccuracy in the company's P35 returns. Given the state of the case law authorities at the time, even if it had sought a second opinion on the tax consequences of the Scheme, it is likely that the company would have been advised that the contributions to the MC EBT and the loans to the directors did not give rise to a liability to account for PAYE income tax.

Discussion

79. Magic Carpets accepts that there was a loss of tax in that it did not account for PAYE income tax in respect of the contributions to the MC EBT and that its P35 returns in the relevant years contained inaccuracies. Accordingly, the two essential questions before the tribunal are:

(1) whether that loss of tax was brought about "carelessly" by Magic Carpets for the purposes of section 36 TMA; and

(2) whether the inaccuracies in the company's P35 returns were "careless" for the purpose of paragraph 3 Schedule 24 FA 2007 in the sense that they were due to the failure of Magic Carpets to take reasonable care.

80. It is common ground that the burden of proof on these issues is on HMRC.

81. The parties also agree that the test as to whether Magic Carpets' conduct amounted to carelessness in both contexts is whether it demonstrated a lack of reasonable care judged by reference to a prudent and reasonable taxpayer in the position of Magic Carpets at the time.

Relevant case law

82. We have been referred by the parties to various decisions of other tribunals on the meaning of "carelessness" in different contexts. We have reviewed those decisions, but we will not recite them all in this decision. The decisions often turn on their particular facts. We accept, however, that some of those decisions provide useful illustrations of the way in which other tribunals have approached this issue and so we will refer to two of them. The decisions to which we will refer in this context are: *Litman and Newall v HMRC* [2014] UKFTT 089 (TC) ("***Litman***"); and *Bayliss v HMRC* [2016] UKFTT 0500 (TC) ("***Bayliss***).

83. *Litman* was a case concerning penalties imposed under the penalty regime that applied before the introduction of the regime in Schedule 24 FA 2007. The relevant provision in *Litman* was contained in section 95 TMA, which imposed penalties where the taxpayer fraudulently or negligently delivered an incorrect tax return. In *Litman*, the taxpayers had implemented a tax avoidance scheme involving the use of capital redemption policies to produce a loss, which they then sought to use to shelter gains on other disposals. The taxpayers' argument was, in essence, that they had relied on their advisers in the implementation of the scheme and the completion of their tax returns, and that, in the context of a taxpayer entering into a pre-packaged scheme, it was reasonable for them to do so (*Litman* [25]-[27]). HMRC on the other hand argued that the taxpayers were negligent because they failed to establish the basic commercial reality of the transactions and so were negligent in relying upon the efficacy of the transactions when completing their tax returns based upon tax advice which was "thin" (*Litman* [30]-[33]).

84. The First-tier Tribunal ("**FTT**") accepted that the taxpayers were entitled to rely on the advice from their professional advisers (*Litman* [36]). However, the FTT nonetheless found

that the taxpayers had been negligent in compiling their returns. It did so against a background of facts that cast doubt on whether a loan of £400,000 – the subject of some of the key steps in the scheme – had, in reality, been made or repaid (see *Litman* [42]-[47]). In that context, the FTT found that the taxpayers were negligent in failing to establish the basic commerciality of the transactions on which the advice of their advisers was based, namely, in the context of the scheme in question, whether the loan had been made or repaid. The FTT said this (at *Litman* [45]):

> 45. Even to relatively sophisticated taxpayers such as Mr Litman and Mrs Newall, a £400,000 loan is a significant sum of money. We have concluded that the taxpayers were negligent in signing their tax returns reflecting transactions which relied on significant levels of financing which they had no evidence had ever been advanced or repaid. We do not think that any statements or advice from their professional advisers can or should remove the obligation on a taxpayer to consider whether the proposed transactions stand up to some basic level of commercial scrutiny. To decide otherwise would be to suggest that it is reasonable for a taxpayer to enter into a transaction believing that it can obtain £400,000 of tax losses for doing nothing other than signing a number of documents provided by their advisers and paying a fee.

85. The FTT concluded (at *Litman* [47]):

> 47. In conclusion, it is this Tribunal's view that the failure to enquire into the basic commercial reality of the transactions entered into by these taxpayers is negligence for these purposes and that a reasonable taxpayer, including one prepared to enter into a packaged scheme like this, 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. The taxpayers should not have claimed the capital losses on their tax returns without at least understanding that an actual transaction had been entered into, that some money had moved and that the transaction was not a sham.

86. In *Litman* therefore the FTT took the view that it was not sufficient for the taxpayers to show that they had relied upon the advice of their professional advisers if they were to demonstrate that they had not been negligent in delivering their returns. In the circumstances of that case, where the taxpayers were sophisticated investors and knew that a loan was required for the purposes of the scheme (*Litman* [42]), it was incumbent on the taxpayers to satisfy themselves as to the substance of the transactions before claiming the losses in their returns.

87. The second case to which we will refer is *Bayliss*. *Bayliss* also concerned an appeal against a penalty imposed under section 95 TMA on the basis that the taxpayer fraudulently or negligently delivered an incorrect tax return.

88. In *Bayliss*, the taxpayer had entered into a tax planning scheme which was designed to create a capital loss. The taxpayer subsequently accepted that the loss was unavailable, but he argued that he had not been negligent in compiling his return as he had relied on his professional advisers. As in the present case, there were some material inadequacies in the implementation of the steps in the scheme.

89. On the question as to whether the taxpayer had negligently delivered an incorrect return, the FTT acknowledged that in many respects the taxpayer's conduct could be described as careless. However, the question before the FTT was whether the taxpayer was negligent in making the error in the return for the purposes of section 95 TMA. The Tribunal said this (at *Bayliss* [65]):

> 65. … 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.

90. In answer to that question, the FTT concluded that HMRC had not demonstrated that the appellant was negligent in filing an incorrect return. HMRC had not discharged its burden of proof. It said this (at *Bayliss* [66]):

> 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.

91. The Tribunal then considered the decision in *Litman* and distinguished the decision in that case on various grounds. The FTT continued (at *Bayliss* [67]-[68]):

> 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.

92. *Bayliss* is a case on the former penalty regime in section 95 TMA. However, the important point that we take from *Bayliss* in our consideration of the application of the penalty regime in Schedule 24 FA 2007 – and which underlies Ms Sheldon's argument for Magic Carpets in this case – is that it is important to demonstrate a causal link between carelessness on the part of the taxpayer and the inaccuracy in the return. That point is, if anything, clearer under the legislation in Schedule 24 FA 2007. The definition of "carelessness" in paragraph 3 Schedule 24 requires the inaccuracy in the return to be "due to" a failure to take reasonable care.

93. In our view, the point applies equally to the extension of time limits by section 36 TMA. Section 36 permits an extension of the usual time limit in section 34 TMA only where the loss of tax is "brought about" carelessly by the taxpayer (or a person acting on the taxpayer's behalf). To adopt the terminology used in *Bayliss*, it is not sufficient to show that the taxpayer was careless "in the abstract". Section 36 only applies where the taxpayer "carelessly brought about" the loss of tax. The careless implementation of a series of steps in a tax planning scheme does not of itself bring about a loss of tax. It is only when the taxpayer, or a person acting on the taxpayer's behalf, completes the tax return incorrectly or fails to complete a tax return, that the loss of tax is "brought about".

Application to the facts of this case

94. As we have discussed above, the parties agree that the relevant test as to whether a taxpayer's conduct should be regarded as careless for the purpose of section 36 TMA and paragraph 3 Schedule 24 FA 2007 is whether the taxpayer has failed to take reasonable care as tested by reference to a prudent and reasonable person in the position of the taxpayer.

95. Applying that test – and leaving to one side, for present purposes, the circumstances in which the taxpayer may be liable for the acts of its agent, to which we will return later in this decision – in our view, in normal circumstances, it would be reasonable for Magic Carpets to rely on the advice of its professional advisers in compiling its tax returns, and it should not be treated as "careless" if it followed that advice. Buckleys were independent professional advisers. They had been recommended to Mr and Mrs Holt by friends and business associates.

96. That basic position must, in our view, be subject to limits where the facts and circumstances dictate that a prudent and reasonable person in the position of the taxpayer would take additional steps beyond simply relying upon their professional advisers. Those limits will be determined by the facts and circumstances of each case. So, in *Litman*, where the facts were such that a prudent and reasonable taxpayer would have made further enquiry into the basic commerciality of the steps in the scheme, the FTT found that the taxpayers were negligent to deliver a tax return on the basis of the advice of their advisers that relied upon the loan in question being and not a "sham" when they knew or should have known that there were material questions surrounding whether or not a loan had in reality been made and repaid.

97. In the present case, we can understand that some aspects of the company's conduct and that of its directors could be regarded as careless: Mr and Mrs Holt made no attempt to understand the steps in the Scheme beyond a vague understanding that it involved an EBT and loans made to them; Mr and Mrs Holt did not ensure that they understood the documents that

the company was entering into; Mr and Mrs Holt did not ensure that the documents were properly executed or that they were signed in the correct chronological order; and Mr and Mrs Holt signed documents that referred to meetings that did not take place. Furthermore, Mr and Mrs Holt knew or should have known that the arrangements with Herald in relation to the employment remuneration review lacked any real substance and should, it might be said, have sought further advice, given that they knew that Buckleys were entering into the Scheme themselves (and so their advice could not properly be regarded as independent) and the discrepancies between Buckleys' assertion that the Scheme was approved by HMRC and the letter from Clavis that clearly stated that it was not.

98. On the other hand, the test requires us to consider the position of a prudent and reasonable taxpayer in the position of the company (acting through Mr and Mrs Holt). Mr and Mrs Holt are not – unlike the taxpayers in *Litman* – sophisticated taxpayers. They are business-people. They did not understand the intricacies of a complex tax planning scheme. They trusted their advisers implicitly and relied on their advisers to implement the Scheme. We accept that they were reassured by the assurances from Buckleys that the Scheme was supported by an opinion from leading counsel and had been approved by HMRC, and that other taxpayers (including Buckleys themselves) had successfully implemented the Scheme.

99. On balance, we have come to the view – given the material inadequacies in the implementation of the Scheme – that the company was careless in, at the very least, not making any further enquiry whether of Buckleys or another adviser. That is what a prudent and reasonable taxpayer would do.

100. We must, however, also address the question on which the FTT focussed in *Bayliss* as to whether that carelessness caused the tax loss or the inaccuracies in the P35 returns. We have considered this point carefully and concluded that HMRC has not discharged its burden to show that there was any causal link between any carelessness on the part of the company and the tax loss or the inaccuracies in the P35 returns.

101. Our reasons are as follows.

(1) First, although there are concerns about the lack of substance in the arrangements for the provision of the employee remuneration review services by Herald, the same concerns do not arise in relation to the elements of the Scheme that are relevant to any PAYE income tax liability. HMRC accept that the MC EBT was established. Payments were made to contribute funds to the MC EBT. Funds were allocated to the Sub-Trust. We have found that the payments made from the Sub-Trust to the directors were in the form of interest-free loans. Although Mr and Mrs Holt knew little of the steps, they did know that the Scheme involved a contribution to an EBT and loans to themselves.

(2) On the case law as it stood at the time, it would not have been unreasonable to take the view that the contributions to the MC EBT and loans to the directors did not attract PAYE income tax. At the time, that conclusion could not have been said to be clearly wrong. Indeed, it would probably have been regarded as the better view. Even if the company had gone as far as seeking independent specialist advice at the time, an independent adviser was likely to have concluded that the Scheme did achieve its aims, at least in relation to the lack of any obligation to account for PAYE income tax in relation to the contribution to the MC EBT and the loans to the directors.

(3) This conclusion is supported by the conclusions of the Independent Loan Charge Review. The loans in this case were all made before 9 December 2010, the date on which new legislation was announced which became the disguised remuneration rules and which was taken by the Review as the date from which taxpayers should have known that any further loans would be treated as taxable remuneration. However, that

new legislation did not affect the position for loans made before 9 December 2010. And it was several years before HMRC were successful before the courts and tribunals in securing a decision (in *Murray Group*) that contributions to and loans from an EBT should be treated as employment income. So, even though the P35 returns for the tax year 2010/11 were not filed until after 9 December 2010, it is unlikely that the view of an independent specialist adviser in relation to the loans made in that tax year would have changed.

102. We should address, at this point, the submissions made by Ms Choudhury for HMRC concerning the lack of substance in the arrangements between Herald and the company regarding the provision of employment remuneration services. We agree with much of HMRC's criticisms of the steps taken by the company in this respect. If this case concerned the claim for a corporation tax deduction in relation to the payments made by the company to Herald, we may well have reached a different conclusion. However, this case does not concern the claim for a corporation tax deduction.

103. Furthermore, we note that, under the provisions in sections 1290 to 1296 CTA 2009, it is the right to claim the corporation tax deduction which is dependent upon the payment of PAYE income tax on the benefits made available to directors and employees. The provision does not operate the other way round. The fact that a deduction has been claimed for corporation tax purposes on the payment made to a service provider, which is in reality a contribution to an employee benefit scheme, does not affect the treatment of the arrangements for PAYE income tax purposes. For these reasons, although we accept many of HMRC's criticisms of these aspects of the arrangements, they do not affect our conclusion.

104. For these reasons, in our view, HMRC has not discharged its burden to demonstrate that carelessness on the part of the company caused a loss of tax or that the inaccuracies in the P35 returns were due to carelessness on the company's part.

THE ACTIONS OF BUCKLEYS

105. We turn next to HMRC's alternative argument: that Buckleys acted as agent for the company; the carelessness of Buckleys caused the loss of tax or the inaccuracies in the return; and that the company is responsible for the acts of Buckleys as its agent.

106. There is no dispute that Buckleys were acting on behalf of the company in relation to its tax affairs.

107. HMRC say that Buckleys were careless in preparing and submitting the P35 returns on behalf of the company:

(1) Buckleys carelessly advised the company to enter into and implement the Scheme; indeed the company brought professional negligence proceedings against Buckleys in the High Court on this basis.

(2) Buckleys failed to advise the company at any stage that the Scheme was not in accordance with the relevant law as reasonably understood at the material time. They failed to advise that HMRC were very likely to challenge the Scheme or the proper implementation of the Scheme because of this.

(3) Buckleys completed and submitted the company's P35 returns without taking any or any reasonable steps to satisfy themselves that the figures in those returns were correct.

108. HMRC also say that the carelessness on the part of Buckleys caused the inaccuracies in the P35 returns and consequently the loss of PAYE income tax in the tax years 2009/10 and 2010/11 in that, had Buckleys exercised reasonable care in advising the company, it would not

have entered into the Scheme or would have withdrawn, the wrong figures would not have been entered into the P35 returns and there would have been no loss of PAYE income tax.

109. As HMRC accepted in the course of the hearing, there was little or no evidence before the tribunal of steps that Buckleys took or did not take to verify the tax implications of the Scheme. The only evidence of Buckleys' role that is before the tribunal is the documentary evidence and the witness evidence of Mr and Mrs Holt.

110. In those circumstances, our conclusion in relation to the actions of Buckleys is similar to that in relation to the actions of the company. For similar reasons to those we have given in relation to the company's own actions, we have come to the conclusion that HMRC has not discharged its burden to show a causal link between the loss of tax or the errors in the P35 returns and any carelessness by Buckleys acting as agent of the company.

111. For section 36 TMA and paragraph 3 Schedule 24 FA 2007 to be in point, HMRC would need to show that there was a causal link between any careless conduct on the part of company or Buckleys acting on its behalf and the errors in the P35 returns. The manner of the implementation of the Scheme could and perhaps should be regarded as careless. In order to establish a causal link, HMRC would have to show the errors should have been of sufficient concern to prompt the company and/or Buckleys to seek advice from an independent and suitably experienced adviser, who would have advised that the arrangements did not work to achieve the PAYE income tax saving. Despite the errors in the implementation of the Scheme, given the state of the case law authorities at the time, it is far from certain that such an independent adviser would have advised that PAYE income tax was due. In fact, it is more than likely that, at the time, such an adviser would have been of the view that the arrangements albeit controversial did achieve the PAYE income tax saving. And, although we largely agree with HMRC's submissions in relation to the lack of substance of the review by Herald of the company's employment remuneration arrangements and the concerns about the claim for a corporation tax deduction for the payment to Herald under them, those arrangements are irrelevant to any liability to PAYE income tax.

DISPOSITION

112. For these reasons, we have come to the view that HMRC has not discharged its burden to show that:

> (1) the loss of tax was brought about "carelessly" by Magic Carpets (or a person acting on its behalf) for the purposes of section 36 TMA; and
>
> (2) the inaccuracies in the company's P35 returns were "careless" for the purpose of paragraph 3 Schedule 24 FA 2007 in the sense that they were due to the failure of Magic Carpets (or a person acting on its behalf) to take reasonable care.

113. We allow these appeals.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

114. 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.

ASHLEY GREENBANK
TRIBUNAL JUDGE

Release date: 01 August 2023