ICAEW
REPRESENTATION 10/21

FOLLOWER NOTICES AND PENALTIES: CONSULTATION RESPONSE

Issued 25 January 2021

ICAEW welcomes the opportunity to comment on the proposals for reforms relating to Follower Notices and Penalties published by HM Revenue & Customs on 16 December 2020 a copy of which is available from this link.

This response of 25 January 2021 has been prepared by the ICAEW's Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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KEY POINTS

1. We support the proposed reduction in the standard rate of penalty for failing to act in response to a follower notice (FN). However, we do not believe that this would be sufficient by itself in balancing the objective of FNs to discourage further litigation of points already settled with the rights of taxpayers to continue genuine disputes.
2. We believe that a further means of appeal against the issue of an FN should be introduced to deal with cases where, for example, the judicial ruling that HMRC believes is relevant to the arrangements into which the taxpayer concerned has entered is not actually relevant to those arrangements.
3. We believe that HMRC should also communicate the rights of taxpayers more clearly when it issues FNs, including all mechanisms and grounds for appeal.
4. We support the possible imposition of a higher penalty for failing to act in response to a valid FN but only where the tax tribunal or court makes a statement that the taxpayer has acted unreasonably in pursuing the case concerned.
5. We believe that this further penalty should be capable of being reduced as result of subsequent cooperation by the taxpayer.

ANSWERS TO SPECIFIC QUESTIONS

Question 1. Do you agree that reducing the penalty rate would better balance the objective of FNs to discourage further litigation of points already settled with the rights of taxpayers to continue genuine disputes?

6. While we welcome the reduction in the penalty rate, we do not believe that this measure would by itself strike the desired balance stated in the consultation document. We believe that there would still be genuine disputes where the taxpayer is discouraged from taking the case to the courts because of the financial cost of doing so. Whilst we accept the additional administrative cost that this would place on HMRC and HM Courts and Tribunal Service, we believe that there should be a mechanism for right of appeal to the First Tier Tribunal (FTT) against the issue of a FN. We believe that an appeal mechanism to a third party is essential to supplement the restricted grounds on which taxpayers can currently make written representations to HMRC in response to FNs issued.
7. For example, HMRC should only issue a FN where it is of the opinion that there is a judicial ruling which is relevant to the tax arrangements into which the taxpayer concerned has entered. A judicial ruling is 'relevant' for FNs if it provides reasons or principles as to why the scheme in question did not work and those reasons or principles, if applied to the person's arrangements, would defeat them. However, there have been examples of judicial review cases where it has been held by the Court of Appeal that FNs was issued based on points in other cases that were not pertinent to those of the taxpayers' case. For example, in *R (on the application of Locke v Revenue and Customs Commissioners)*, Rose LJ commented that HMRC could not have lawfully held the opinion on which this FN was based.
8. Taxpayers also currently have the right to apply for judicial review of the FN issued but this is a costly process which is beyond the financial means of most taxpayers. An appeal to the First Tier Tribunal should prove more cost-effective and provide a mechanism whereby the validity of a FN can be considered other than by HMRC itself.

Question 2. Do you have any further suggestions to better achieve this balance?

9. The right of appeal to the FTT referred to above could be limited to the specific question as to whether HMRC is right to conclude that the judicial decision arising on a test case applies to the case that is the subject of the FN. The FTT already has power to strike out a hopeless appeal and to award costs against an appellant who has acted wholly unreasonably in relation to his or her appeal so it would seem reasonable for it to consider this point also.

10. We believe that publication and promotion by HMRC of taxpayers' rights in relation to Follower Notices would further help to achieve this balance. The FN regime is somewhat confusing even to represented taxpayers. For example, sometimes a taxpayer appeals against an assessment or enquiry closure notice regarding an avoidance arrangement on several grounds. Whilst the FN effectively deletes any argument that the scheme itself works (unless the taxpayer wishes to fight on notwithstanding the FN penalties), taxpayers are sometimes confused about how to deal with a FN where there are other grounds for their appeal unrelated to the scheme (eg, an argument that HMRC missed the assessment time limit thus invalidating the discovery assessment). HMRC could make this clearer in the paperwork it issues to taxpayers with the FNs and in its guidance, so that taxpayers better understand how to respond to the FN if they want to continue their appeals on those other grounds and how they fit with the 'reasonable in all the circumstances' appeal grounds referred to in paragraph 2.8 of the consultation document.

Question 3. How effective do you believe a further penalty would be as a deterrent to timewasting litigation of avoidance schemes?

11. We believe that the further penalty may prove to be an effective deterrent, but that depends on the extent to which the taxpayer believes that the appeal is valid and would not be struck out by the FTT.

Question 4. Are the suggested criteria the correct ones to adopt? Do you have any further suggested criteria to apply?

12. We believe that the penalty should apply where the tax tribunal or court makes a statement that the taxpayer has acted unreasonably in bringing or conducting the proceedings but not where the tax tribunal or court strikes out a taxpayer's appeal. We hold this opinion for two reasons.

13. Firstly, charging a penalty for acting unreasonably mirrors the unreasonable conduct rule under which a costs order may be sought (Tribunal rule 10 (1) (b)). Applying the same test would achieve simplicity and consistency such that taxpayers and advisers would not have a new test to understand and apply.

14. Secondly, we believe that striking out an appeal already achieves the objective of preventing the pursuit of a hopeless appeal. Also, HMRC can apply to the Tribunal to strike out the appeal at any time after it has been lodged, which could be before the FN has been issued. In that case, no FN penalty would arise, so it seems unfair to taxpayers to impose a penalty if the strike-out took place after the FN has been issued. Of course, a Tribunal could also make a statement that the taxpayer has acted unreasonably in bringing or conducting a case, but this would generally only be where an appeal is made which is bound to lose because the Supreme Court has decided a case against a taxpayer with virtually identical facts. We believe the latter case would be sufficient grounds for an additional penalty.

Question 5. Are these the correct conditions to apply before such a further penalty can be issued? If not, what other criteria do you suggest?

15. We believe that the first condition set out at paragraph 2.13 of the consultation document should read 'a valid FN was issued'. This would mean, for example, that if an FN is found to

be subsequently not appropriate by the FTT after it had been issued (a mechanism suggested in our response to Q1 above) or the FN was found to be issued in error, then a further penalty could not be applied.

Question 6. Do you believe the further penalty should be reducible to reflect further cooperation by the recipient of a FN? If so, what factors should be taken into account?

16. Yes, because further co-operation by the taxpayer after the penalty has been issued would help to resolve the case more quickly. If the penalty were to be reduced as a result of the taxpayer agreeing to settle any outstanding tax within a set time frame after the penalty is issued, then this would result in improved cashflow for the Exchequer. It may then make economic sense for HMRC to make reductions in the penalty to reflect this.

Question 7. Would these grounds of appeal provide sufficient safeguards for taxpayers incurring this penalty? Are there any other appeal grounds you think should be applicable?

17. Assuming that the additional penalty can only be issued in cases where a tribunal or court has held that the taxpayer has acted unreasonably in bringing or conducting the proceedings, it seems reasonable that this penalty may only be appealed on the grounds that it has been issued in error.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).