Court of Appeal Judgement

in Robert Huitson and HMRC

Described by Lord Mummery in his introduction as "a very unusual income tax case", it was a challenge to HMRC on the retrospective legislation initially flagged up by the 2008 Budget Note 66 on Double Taxation Treaty Abuse which became s.58 Finance Act 2008.

Mr Huitson was seeking to argue that the legislation infringed his human rights as, before the legislation was amended with retrospective effect, he was entitled to relief from UK income tax on income received by him from a trust in the Isle of Man.

In a case which has dealt a blow to many schemes which involved similar planning, the Court of Appeal has determined that the original Court decision was correct and that the Government was entitled to recover the lost tax which in Mr Huitson's case amounted to £195,000, but in total was estimated as being some £100million in lost funds to the Treasury.

Two key issues have arisen from this case: firstly, if the Government can show that it has balanced the interests of the individual with those of the wider community, then it has nothing to fear from a challenge to this kind of retrospective legislation; secondly, the purpose of Double Taxation Agreements is to protect the taxpayer from paying tax twice on the same income, not as a means for mitigating tax.

Background facts

From June 2001, Mr Huitson (the claimant) became a client of Montpelier Tax Planning (Isle of Man) Limited and participated in a tax avoidance scheme operated through a partnership and a trust located in the Isle of Man. It was designed to take advantage of the Double Taxation Treaty (DTA) provisions for claiming relief from UK income tax on specified income paid to a UK resident. Under the scheme Mr Huitson provided his services as a self-employed IT consultant to end users in the UK through an intermediary partnership called the Allenby Partnership. Allenby received full payment for his services. Under the consultancy agreement Mr Huitson received a fixed annual fee which was subject to UK tax.

The tax avoidance aspect of the scheme arrangement focused on fee income that was channelled to the claimant through his Manx trust. That income was generated by the claimant's activities through the Allenby Partnership. The partnership paid profits to a trustee, which then made payments to Mr Huitson in the UK in his capacity as the beneficial owner of the trust.

It was noted by the original Judge that an IT consultant participating in the Isle of Man scheme had the competitive advantage of an effective income tax rate of 3.5% over a consultant who did not participate in the scheme.

From 2002 onwards, Mr Huitson submitted tax returns claiming Double Taxation Relief in respect of the trust income on the basis that the DTA was effective to exempt from UK income tax on his share of the partnership profits. Mr Huitson's claim was that as a result of the DTA provisions and the legislation then in force, the income channelled to him through his Manx trust was not subject to UK income tax.

HMRC did not challenge the validity of the DTA claims in Mr Huitson's tax returns until June 2004 and gave no reasons for the challenge until February 2006. HMRC advised Mr Huitson to make payment on account in respect of the disputed tax to interest and possible penalties. In May 2007, HMRC informed him that they were preparing representative cases to take to the Special Commissioners regarding the validity of the claims to Double Taxation Relief. Before the cases were listed for Hearing, the Government announced in the March 2008 budget that legislation would be enacted to render the tax avoidance scheme ineffective beyond doubt.

On 21 July 2008, s.58 of the 2008 Act came into force and amended, with retrospective effect, the existing legislation so as to render the tax avoidance scheme ineffectual *and* to impose on the claimant and others in a similar position liability to pay UK income tax on the trust income received in past years.

The original challenge (January 2010) to the legislation considered a range of public interest issues and in all areas the judgment of the original court was upheld by the Court of Appeal:

- It was claimed that the change in legislation was a retrospective deprivation of "possessions" – here the right to claim tax relief. However, it was clear from both the original judgement and the Court of Appeal's considerations that, Mr Huitson had entered into a tax avoidance scheme that was wholly artificial and which may in any event not have produced the desired result. Therefore this point was not accepted.

- The residence of individuals and partnerships exercising a trade or profession is key: residence is *the* connecting factor which entitles a State to impose income tax and the resident of a State has a reasonable expectation of being taxed by the State in question on the income of a trade or profession.

- HMRC had never accepted and had challenged the interpretation of the legislation relied on by those who asserted the efficacy of the scheme. Nor had HMRC indicated that they would never bring proceedings or suggest that no legislation would be enacted, or that any such legislation would only have an effect moving forwards.

- Both courts argued that the legislation had avoided the costs, delays and uncertainties of litigation about the efficacy of the scheme and re-asserted Parliament's long standing intention that DTAs would not affect a UK resident's liability to tax on his share of income from a foreign partnership.

- The State was not obliged, before enacting retrospective legislation about the tax scheme, to test its efficacy in the courts and to allow the claimant, if successful, to keep the fruits of his victory.

- DTAs respect the principle of taxation by the State of residence. They aim to avoid the taxation of residents twice over on the same income. What DTAs do *not* aim to do is to facilitate the avoidance of tax, or its reduction below the level of tax ordinarily paid by residents. In principle retrospective legislation may be justified for the purpose of implementing that policy.

- More generalised objections were also made about the distressing personal consequences of the retrospective provisions for individual users of the scheme: some taxpayers would face bankruptcy, financial worry, health problems and marital breakdown.

Grounds of appeal

The bullet points above were the mainstay of the appeal and the Court of Appeal confirmed Judge Parker's original decision and dismissed the appeal.

Lord Mummery argued that Judge Parker *"was not wrong to conclude in his comprehensive, clear and excellent judgment that the retrospective provisions of the 2008 Act are proportionate and are compatible with Article 1. There are no grounds which would entitle this court to disturb it."*

The Judge concluded:

"In summary, the retrospective amendments were enacted pursuant to a justified fiscal policy that was within the State's area of appreciation and discretionary judgment in economic and social matters. The legislation achieves a fair balance between the interests of the general body of taxpayers and the right of the claimant to enjoyment of his possessions, without imposing an unreasonable economic burden on him. This outcome accords with the reasonable expectations of the taxation of residents in the State on the profits of their trade or profession. The legislation prevents the DTA tax relief provisions from being misused for a purpose different from their originally intended use. There has been no conduct on the part of the State fiscal authorities that has made the retrospective application of the amended legislation to his tax affairs an infringement of his Convention rights."