



# Gaines and losses

## KEY POINTS

- The disappointing outcome of the Supreme Court appeal is not wholly bad news for other taxpayers
- Keith Gordon finds himself in agreement with the dissenting judgment, and raises concerns about the implications of the case for trust between HMRC and tax advisers
- The doctrine of legitimate expectation has, however, found favour with their Lordships

*Keith M Gordon* considers the consequences of the Supreme Court's decision in the taxpayers' unsuccessful appeals in *R (oao Davies & James) (and related appeal)* [2011] UKSC 47

**B**y now, most readers of this article will be aware that the Supreme Court dismissed, by a 4–1 majority, the taxpayers' appeals in the case widely referred to as 'the *Gaines-Cooper* case'.

This article considers the consequences of their Lordships' decision and what it means for other taxpayers who relied upon the former Inland Revenue's IR20 booklet and those other cases where

## PROFILE



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HMRC make a promise to taxpayers concerning their tax position.

### The facts of the cases

Most of the arguments in both appeals focused on the interpretation of paras 2.7 to 2.9 of the 1999 edition of IR20. Those paragraphs, to paraphrase, provided that an individual would be treated as neither UK-resident nor UK-ordinarily resident if:

- the individual has gone abroad either permanently, for at least three years or for a settled purpose;
- the absence covers at least a whole tax year; and
- return visits total less than 183 days in any tax year and average less than 91 days per tax year (over a four-year period).

Despite this common theme, the underlying facts of the two cases were fundamentally different.

Mr Gaines-Cooper had originally argued that he had ceased to reside in the UK in the 1970s and had instead settled permanently in the Seychelles, while nevertheless maintaining ties to the UK in the meantime. Despite these assertions, he had been assessed on the basis that he was both UK-resident and UK-domiciled (he had an English and Welsh domicile of origin) and his appeal against these assessments was unsuccessful before the Special Commissioners. In parallel, he had commenced a claim for judicial review because he considered that the underlying basis of the assessments (ie his UK-residence status) breached the undertakings given in the IR20 guidance.

Messrs Davies and James went to live in Belgium in March 2001 where they worked for a company that they had set up. They maintained even more links to the UK than did Mr Gaines-Cooper: in fact, their families remained in their respective family homes in Wales throughout the period of absence. Although the taxpayers could have argued that, notwithstanding their families remaining in the UK, they had ceased to reside in the UK, such an argument was unnecessary if they could show that they fell to be treated

as neither UK-resident nor ordinarily resident in the UK in accordance with the promises in IR20. For this reason, Messrs Davies and James chose to proceed first with a claim for judicial review rather than have their appeals determined by what is now the First-tier Tribunal.

Although the oral arguments before the Supreme Court focused on paras 2.7 to 2.9 of IR20, Messrs Davies and James also made a claim based on para 2.2. That paragraph contained a separate promise that individuals would be treated as non-resident in cases where the individuals had gone abroad for the purposes of full-time employment (or self-employment) overseas.

### The respective arguments

The arguments before the Supreme Court on paras 2.7 to 2.9 had two main strands: first, it was argued that each of the taxpayers had complied with the conditions contained in the IR20 guidance (if properly interpreted) and, therefore, the doctrine of 'legitimate expectation' meant that HMRC had acted unlawfully in treating them as if they were still resident and ordinarily resident in the UK.

So far as this strand is concerned, the main difference between the parties was the extent to which UK ties had to be severed before an individual could start to consider the quantitative tests inherent in IR20. HMRC argued that a taxpayer needed first to effect a distinct break from the UK (so as to cease to be UK-resident). HMRC's argument was that paras 2.7 to 2.9 would then provide guidance to such former-residents as to how often they could return to the UK without becoming treated again as resident in the UK. The taxpayers' argument, on the other hand, was that the only pre-condition was that there should be a sufficient change in circumstances so as to amount to 'going abroad'. In this way, the prerequisite departure from the UK (and relaxing of UK ties) is no more exacting than required for the purposes of para 2.2: in other words, the continuing residence of spouses and minor children and the retention of other UK ties are irrelevant.

The second strand of the argument was that, even if the correct interpretation of IR20 was as argued for by HMRC, there had



been a retrospective change of practice by HMRC (or the former Inland Revenue). Again, such a change would breach a taxpayer's legitimate expectation and the court should order the assessments to be quashed. HMRC denied that there had been such a change.

### The court's decision

#### The majority

The majority of the Supreme Court (Lords Hope, Walker, Clarke and Wilson) dismissed the taxpayers' appeals on both grounds. They considered that the proper interpretation of paras 2.7 to 2.9 (based upon its history and context) and the words 'go abroad' required taxpayers to become non-resident first, before the day-count tests could be employed. In Mr Gaines-Cooper's case, the Special Commissioners' previous decision on the point has conclusively ruled against him on this point.

In relation to the second strand of the argument, the majority considered that there was insufficient evidence to support the taxpayers' arguments that there had been an impermissible change of practice concerning the interpretation of those paragraphs: all that could be seen was that the Revenue had started to take a

more proactive approach to verifying claims of non-residence based upon paras 2.7 to 2.9.

### **The dissenting judgment**

Lord Mance gave a dissenting judgment. He considered that the majority had reached their conclusion by reading IR20 as if it were a Parliamentary statute, whereas a more natural reading (given its intended readership) supported the taxpayers' arguments. For example, Lord Mance said:

... the suggestion that the distinct break test is implicit in the paragraphs [2.7] to 2.9 (though not in that of paragraph 2.2) appears to me remarkable in the light of the obvious importance of such a factor if it were envisaged. Paragraphs 2.7 to 2.9 of IR20 are essentially futile, indeed positively misleading, if they are read as incorporating or reiterating the difficult case law test of a distinct break, and moreover imposing a further specific restriction (a 91-day average limit) to the taxpayer's disadvantage.

Lord Mance chose not to comment on the second strand of the argument.

### **Commentary**

As someone who first encountered IR20 nearly 20 years ago, during my accountancy training, and who observed many individuals being advised upon its contents, I have always had considerable sympathy for the taxpayers in these appeals.

Turning first to the taxpayers' second strand, I personally find it difficult to believe that the former Inland Revenue always interpreted what became paras 2.7 to 2.9 in a stricter way than para 2.2. Even the circumstantial evidence considered by the Supreme Court seemed to suggest that there had been such a change, although the court considered that the evidence before it was insufficient to demonstrate an unlawful change of practice.

With respect to the first strand, I find myself in complete agreement with what Lord Mance concluded. Any ordinarily reasonable reader in my view would interpret paras 2.7 to 2.9 as requiring no more than a mere change of circumstances to amount to 'going abroad', as countless accountants and other tax advisers had assumed it to mean since the IR20 booklet was first published at the end of 1972. It is of no consequence that a forensic approach to the interpretation of the booklet (as carried out by the majority) might yield a distinct outcome (as indeed the majority

concluded it did), because the document ought to be interpreted in accordance with how its intended readership would construe it, and not how five of the country's most skilled lawyers would choose to interpret it.

I was also unimpressed by the majority's suggestion that any taxpayer who wished to obtain firm confirmation that s/he could be treated as non-resident in his or her personal circumstances could always seek the advice from their local tax office. First, such tax offices are becoming more of a rarity; second, and particularly in the era of self-assessment, it is now nigh on impossible to get such a ruling; finally, my understanding is that whenever a taxpayer requested confirmation that they would be treated as non-resident, the normal reaction of the local tax office would be to send out a copy of IR20.

So where does this leave taxpayers? Is the decision totally bad news? For the taxpayers themselves, the decision is, of course, a bitter disappointment. Similarly, the decision will not have been welcomed by those other taxpayers whose own cases were dependent on the outcome of the

was held to be unsuccessful because of the specific facts of their case and not the underlying meaning of the paragraph. For what it's worth, I am not sure that the Supreme Court fully grappled with the arguments raised on the taxpayers' behalf on this point; this might be because the point was dealt with only by written submission and was not really addressed during the hearing itself.

Third, the Supreme Court made it clear what should happen when a case is the subject of two parallel challenges: a conventional appeal in the First-tier Tribunal and a claim for judicial review in the High Court (or the Court of Session) or where such a claim has been transferred to the Upper Tribunal. This issue was the subject of some debate earlier on in this case when HMRC were arguing in *Davies and James* that the matter should be first determined by the Tribunal, whereas in *Gaines-Cooper* they were arguing that the Special Commissioners' finding in that case precluded a subsequent claim for judicial review. The court confirmed that the judicial review claim should be dealt with first in such cases.

**“ The judgment is perfectly clear that those individuals who commence full-time work abroad will, by concession, be treated as non-resident even if they retain significant links with the UK during their 'absence' ”**

appeal. The decision should also serve as a warning to taxpayers seeking to rely upon an extra-statutory practice if there is any realistic possibility that HMRC would seek to distinguish the case from that covered by the guidance. However, for other taxpayers, there are some positive aspects.

First, the Supreme Court decision has once again confirmed the principle that taxpayers can rely upon promises made by HMRC and contained in general guidance. The difficulty in the present case was that the majority concluded that the guidance did not have the meaning that the taxpayers understood it to have.

Second, those taxpayers whose cases are based upon para 2.2 ought not to be adversely affected by the decision: the judgment is perfectly clear that those individuals who commence full-time work abroad will, by concession, be treated as non-resident even if they retain significant links with the UK during their 'absence' and therefore do not actually cease to be UK-resident. Furthermore, it is clear that this continues to represent HMRC practice, so that any change in approach by HMRC would have to be prospective if it is to avoid a challenge by way of judicial review. The alternative argument in Messrs *Davies and James's* case that turned on para 2.2

So far as the issue of residence is concerned and assuming that the proposed statutory residence test will come into effect from 6 April 2012, a lot of the discussion in this case will become academic – although the underlying principles will continue to be valid. However, whether or not HMRC's arguments were right (as the majority of the Supreme Court has held) – and it should always be remembered that a brave and wealthy taxpayer is free to revisit the second issue if armed with sufficient evidence to substantiate the alleged change of practice – the '*Gaines-Cooper* episode' has exemplified the deterioration in the relationship between HMRC and taxpayers in recent years. For example, HMRC vigorously opposed the taxpayers even being given permission to make a claim for judicial review – a strategy that was subject to very strong criticism from the Court of Appeal early last year.

Furthermore, I do not know of a single adviser who is convinced by HMRC's assertions that their practice in relation to paras 2.7 to 2.9 had not changed; HMRC's continued assertions to the contrary do not help relations which are so dependent on mutual trust. Let's hope that HMRC recognise the need for this trust and learn from this case.