

Sorry, my mistake! (Tax back please?)

(Lecture P1233 – 20.49 minutes)

It goes without saying that tax cases before the tribunals and courts are normally decided on the basis of tax law. However, when tax law is against you, an appeal on the grounds of the equitable law of 'mistake' may be successful, as has been demonstrated several times in recent years.

'Mistake' appeals – key points of principle

Mere ignorance, forgetfulness or a misprediction will not be a mistake that the law will recognise as such. For a transaction to be set aside on the basis of mistake, there must be a 'causative mistake' of sufficient gravity that it would be 'unjust or unconscionable' to leave the mistake uncorrected. This will usually only be satisfied when there is a mistake as to the legal character or nature of a transaction, or as to some matter of law or fact that is fundamental to the transaction.

Pitt v Holt

Pitt v Holt [2013] UKSC 26 concerned the scope of 'Hastings-Bass doctrine'. Broadly, this allows those acting in a fiduciary capacity to unwind arrangements into which they have entered, where there are unforeseen consequences. The Court confirmed that the doctrine could not apply where an appellant had (like Mrs. Pitt) taken professional advice beforehand, as they had complied with their statutory duties as a fiduciary.

She had been acting under a power of attorney for her husband, who had been severely injured in an accident and received a large insurance payment. She had settled this on trust for him but had not created a disabled person's trust, resulting in substantial unnecessary inheritance tax (IHT) charges.

The Court, though, also considered the equitable remedy of mistake. The judges unanimously felt that her rather straightforward circumstances warranted this remedy, as there had been a causative mistake so grave that it would have been 'unconscionable' to refuse relief. The same Court, however, reached the opposite conclusion in *Re Futter UKSC 26*, where the mistake concerned how anti-avoidance rules affect UK beneficiaries of offshore trusts.

Pitt v Holt has since been cited in several other tax cases.

Investment bonds

Joost Lobler v HMRC [2015] UKUT 152 concerned the partial encashment of offshore investment bonds, which are issued in segmented form. The appellant ticked the box on the form for a partial encashment of all the segments, rather than opting to encash a certain number of whole segments. This produced a chargeable event gain of over £1 million, despite there having been barely been any increase in value of the bond. Had he ticked a different box, the gain would have been negligible.

The Upper Tribunal referred to Pitt v Holt and allowed the appeal on the grounds of mistake. Note, though, that this remedy may be unnecessary for investment bonds now, due to s.9 F(No.2)A 2017, which inserted s.507A ITTOIA 05. This allows a taxpayer to apply to HMRC for a review of the calculation of a chargeable event gain, on the grounds that it is wholly disproportionate to the economic gain.

Error causing loss of pensions fixed protection.

The appellant in *Gary Hymanson v HMRC (TC06815)* had claimed 'fixed protection' when the pensions lifetime allowance was cut. This allows a claimant to keep the higher allowance, but the protection is withdrawn if the investor has any further pension inputs whatsoever. He had stopped contributions to his main pension scheme but failed to stop some minor direct debits into other pension schemes. The judge confirmed that HMRC had been correct to withdraw fixed protection. However, citing *Pitt v Holt*, he said that he felt an appeal to the Upper Tribunal on the grounds of mistake would certainly succeed, so allowed the appeal at the First-Tier Tribunal rather than make the appellant go through this process. The loss of fixed protection would have meant extra tax of around £50,000.

Unwinding a trust

In *Suckling v Furness and others [2020] EWHC 987 (Ch)*, the 80-year-old appellant, in what her solicitor had advised was a tax neutral transaction, established a life interest trust over business property, with herself as life tenant and remainder to her disabled children.

However, her solicitor, despite being a member of STEP, seemed to be unaware of the major tax changes to trusts of recent years, in particular the FA 2006 changes to the IHT regime. In fact, for tax purposes, this arrangement was far from neutral. For CGT, this was a settlor-interested trust, so the gain arising on creation could not be deferred by holdover relief. Worse still, for IHT there was an immediately chargeable transfer of value on creation of the trust, an IHT charge every 10 years and a gift with reservation of benefit, meaning her share of the property would still be chargeable in her estate on death!

Unsurprisingly, the remedy of mistake was again granted.

It's not cricket!

Legendary 2005 Ashes-winning captain Michael Vaughan had many successes on the cricket field but did not do so well at the High Court earlier this year (*MV Promotions Ltd and another v Telegraph Media Group Ltd and HMRC [2020] EWHC 1357 (Ch)*). The renewal of his contract with Telegraph Media had been mistakenly done in his name, rather than that of his PSC, so that he would be directly taxable on the amounts earned under the contract.

The High Court held that the contracting parties were Telegraph Media Group Ltd and Michael Vaughan and that any reasonable reader of the contract would not conclude otherwise. The necessary preconditions for rectification on the basis of mistake existed but rectification is always at the Court's discretion. Here, the Court said that no rectification was possible if all issues between the parties had been resolved and rectification was sought only to achieve a tax saving.

Conclusion

If a causative mistake has led to 'unconscionable' tax charges and tax law does not provide a remedy, equity may do so, but this will always be at the Court's discretion.

Contributed by Kevin Read