TC04286

Appeal number: TC/2012/02521

Corporation Tax on capital gains - penalty imposed on Appellant on the basis that its return had been negligent - Appeal allowed

FIRST-TIER TRIBUNAL

TAX CHAMBER

HEREFORDSHIRE PROPERTY COMPANY LTD **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE HOWARD M. NOWLAN

MRS SONIA GABLE

Sitting at the Royal Courts of Justice in London on 2 to 4 February 2015

Simon Myerson QC on behalf of the Appellant

Peter Massey of HMRC on behalf of the Respondents

DECISION

Introduction and background information

1. This was an Appeal against a penalty of £162,401 (being 25% of the tax charged on the Appellant's disposal of a real property) imposed on the Appellant, in relation to transactions effected in September 2005.

2. In outline, the Appellant's principal or only shareholder, and certainly its controlling director, Mr. Smeal, decided, following serious ill-health, that he should simplify and rationalise his assets, and that the Appellant should sell the substantial investment property that it owned and distribute the proceeds to him. Having concluded that the cumulative total of Corporation Tax on the disposal, coupled with the tax on distributing the proceeds to himself as shareholder, was something in the region of 68% of the gain, which he considered to be excessive, he sought advice from the firm Montpelier Tax Consultants (Isle of Man) Limited ("Montpelier") that he had used on one previous occasion, as to whether he could mitigate these tax charges.

3. Montpelier informed Mr. Smeal that they were implementing a scheme for clients that it was believed should create an allowable capital loss that the Appellant could realise and offset against the gain on the property. The essence of the scheme was that on account of the way in which the redemption amount in respect of an insurance policy was taken into account for the purposes of the tax on income provisions dealing with "chargeable events", it was strongly arguable that, even if the chargeable event provisions occasioned no or virtually no charge to tax (i.e. because the occasion of charge, the redemption of the policy, realised no gain in excess of the premium paid for the policy), nevertheless under the capital gains provisions, the feature that the redemption amount had been "taken into account" for income purposes meant that the whole redemption amount would be disregarded for capital gains purposes. Since the same analysis did not apply to the acquisition of the policy and to the base cost of the policy for capital gains purposes, the result should be that on the redemption of the policy there would be an allowable loss equal to the non-disregarded cost, compared with the consideration (nil or virtually nil on the above analysis). It was explained that in order for the scheme to succeed, the person disposing of the policy had to be a "second" or subsequent holder of the policy, and that the person disposing had to have acquired the policy otherwise than by purchase, and that the policy had to rank as an asset for chargeable gains purposes and an insurance policy.

4. Mr. Smeal understood, either at the outset or certainly in due course, that similar schemes were being marketed and used quite widely. We were told that he knew at some point that KPMG and Grant Thornton were marketing similar schemes. Mr. Smeal had been satisfied with Montpelier's advice and performance on the previous occasion on which he had used their services and so he decided to proceed with the scheme, possibly fortified in the belief that the scheme was both legal and well researched by the fact that other very well-known firms were also promoting broadly similar arrangements, and that his research on the internet suggested that the scheme was a "widely used tax planning tool".

5. We will ignore at this point the detail of the way in which the Montpelier scheme was actually implemented. It is sufficient at this stage to say that the Montpelier scheme was implemented, and that duly advised by Montpelier, the Appellant declared on its tax return its capital gain on the

disposal of the property, the loss claimed in respect of the redemption of the policies acquired under the scheme and the DOTAS number of the Montpelier scheme.

6. In due course, the Special Commissioners, the High Court and the Court of Appeal all decided in the case of *Jason Drummond v. HMRC* [2009] EWCA Civ 608, an appeal in relation to a substantially similar scheme, that the scheme failed on the fundamental point that the feature that the redemption amount should be excluded from the consideration for capital gains purposes, merely because it was taken into account (without charge) under the "chargeable event" income provisions, was wrong. This decision in principle meant that even if there were minor differences between the various different schemes, the Montpelier schemes were certainly undermined by this conclusion, and since there was no appeal to the House of Lords, the decision was plainly final.

7. As a result, the Appellant conceded that its scheme had failed and the claim for the loss was withdrawn and the tax on the capital gain on the real property disposal was paid.

8. In due course, HMRC notified the Appellant that they considered that, although the Appellant's scheme had been undermined, and the loss claim withdrawn, essentially because of the decision in *Drummond*, all the participants in the Montpelier schemes were to be charged penalties on the basis that the Montpelier schemes would also have failed because of "implementation defects", or indeed possibly because "nothing had happened at all", and that because the taxpayer clients of Montpelier ought to have appreciated this, they were negligent either in having implemented the schemes without seeking further independent advice, or by not challenging the basis on which the schemes were implemented, or in some way submitting wrong tax returns. In contrast we understood that no penalties were sought from taxpayers who had implemented schemes offered by other promoters such as KPMG and Grant Thornton.

9. The level of penalties presumably varied as between the various Montpelier clients. We were told, however, that the Montpelier scheme had been implemented by 259 taxpayers, and that penalties had been imposed on 134 of those taxpayers. With the possible exception of just one participant in the Montpelier schemes, we were told that the explanation for not charging penalties in the case of those participants on whom penalties had not been imposed was invariably because an individual taxpayer may have died, a corporate taxpayer may have been rendered insolvent, or a taxpayer may have left the UK. In other words we were told that in all those cases where it was practically feasible to seek penalties then, with the possible (slightly confused) exception of one single person, penalties were sought. We were also told that HMRC had understandably sought in many cases to procure that taxpayers eventually agreed to the penalties imposed (or possibly to marginally reduced penalties agreed during the course of negotiations) rather than face any challenge before the First-tier Tribunal in relation to the imposition of the penalties.

10. In the course of negotiation, Mr. Smeal offered to settle HMRC's imposition of the penalty on a without prejudice basis, and simply so as to achieve finality, by paying a 10% penalty. The relevant HMRC officer who had dealt with the penalties imposed on every relevant taxpayer, namely Mrs. Gillian Duffy ("Mrs. Duffy") declined to accept this offer, but countered with an offer to settle for a 15% penalty. Mr. Smeal chose to refuse that offer, both because he considered the relevant amount of penalty to be relatively significant and because in principle he objected to the proposition that he and the Appellant had been negligent in any way.

The issues before us

11. It accordingly falls to us to decide whether the penalty should be confirmed, adjusted, or rejected.

12. We can best address these issues by dealing with the following issues:

- First, we need to describe the basic intended steps of the Montpelier scheme;
- We then need to describe how it was actually implemented, particularly in the respect that certain payment steps were short-circuited.
- We will then summarise most of HMRC's criticisms of the implementation steps, and their claim either that "nothing in reality had happened", or that if the policies provided by the Montpelier scheme had been acquired, they had been acquired by purchase by the Appellant itself, such that the scheme would have been ineffective on that ground.
- Whilst the material question in this Appeal is whether Mr. Smeal, being responsible for the Appellant's transactions and its tax return could and should have perceived flaws in the implementation steps of the Montpelier scheme, such that he should either have sought verification of further matters, or sought independent tax advice, and that his failure to do either meant that the Appellant was responsible for negligence in filing its tax return and claiming the loss, we do need to consider the preliminary question of whether there were indeed material implementation failures in the scheme. We cannot, and do not need to address this question in the comprehensive manner that would have been required, were it essential for us formally to decide this question. We do need, however, to consider it because it is a natural preliminary issue to the more fundamental question of the claimed negligence on the part of Mr. Smeal and the Appellant.
- The next, and the critical, issue is whether Mr. Smeal should or could have perceived implementation deficiencies in the Montpelier scheme, such that he and the Appellant were negligent in submitting the Appellant's tax return with a claim for the loss.
- Finally, if we conclude that the Appellant was negligent in submitting its tax return as it did, there is the final question of whether we accept the degree of mitigation of penalty granted by HMRC in settling the penalty at 25%.

The intended steps of the Montpelier scheme

13. As we mentioned in paragraph 3 above, it was a fundamental requirement of the Montpelier scheme that the entity redeeming the policies had to have acquired them otherwise than by purchase. In order to satisfy this requirement, the basic intended steps of the scheme were that:

- a Montpelier company (the Isle of Man company MTM Holdings Limited ("Holdings")) would advance a short-term, interest-free and unsecured loan of £2.5 million to the Appellant;
- the Appellant would form and capitalise a new unlimited subsidiary company, namely Heletec Solutions ("Heletec") by injecting the £2.5 million in subscribing the shares of Heletec at a premium;
- Heletec would then purchase, by assignment, 10 policies, each for £250,000, issued by a Montpelier insurance company formed in Barbados ("Ins.co") and held prior to the steps of the scheme by another Montpelier company, the Isle of Man company, Mossbank Enterprises Limited ("Mossbank");
- following its purchase of the policies, Heletec would distribute the policies up for no consideration (either as a distribution or in reduction of capital) to its parent company, the Appellant;

- the Appellant would then redeem the policies, receiving £2.5 million, plus apparently a surplus of £188, reflecting the growth on the policies realised during the short period in which they had been in issue; and
- finally the Appellant would repay the short-term loan advanced at step 1 by Holdings.

The actual steps of the Montpelier scheme

14. Whilst the Appellant's claim was that the effect of the actual steps of the scheme was that the transactions just indicated had all occurred in the required sequence, the actual implemented steps collapsed some of the steps together in a somewhat tactless and provocative manner, and certainly most of the cash movements were short-circuited.

15. Accordingly, the first of two preliminary steps (both on 16th September 2005) involved Holdings offering an interest-free and unsecured loan of £2.5 million to the Appellant, repayable on or before 31st December 2005, with the second being an intimation by Holdings to the Appellant that it had identified 10 suitable insurance policies that were available to be purchased. Mossbank also offered to sell the numbered policies to the Appellant. At this stage, Heletec was not owned by the Appellant. The Appellant did not accept the offered sale of the policies and it wrote to Holdings, noting that Holdings had identified suitable policies "which may be available".

16. On 19th September 2005 the Appellant resolved to acquire Heletec from the formation agent, and it resolved to subscribe £2.5 million at a premium for the 250 shares of Heletec, the share subscription being satisfied by Heletec "accept[ing] a loan from [Holdings] in the letter terms attached herewith to be advanced as capital to Heletec Solutions."

17. One hour later, Heletec resolved to accept the capital injection of £2.5 million, in return for the issue of its shares, and it resolved to acquire the numbered capital redemption policies issued by Ins.co for £2.5 million.

18. We were not shown any notification sent to Mossbank (the company that had offered the policies to the Appellant) that Heletec wished to accept the offer of the policies that had been made to the Appellant and we were not shown any assignment of the policies. All that we were shown was a letter to Holdings from the Appellant in which the Appellant referred to "our loan agreement", and instructed Holdings "to transfer [the £2.5 million] to the account of Mossbank". We were then shown an endorsement on the policies made by Ins.co to the effect that the policies had been transferred to Heletec.

19. Following Heletec's acquisition of the policies, and on 20th September, Heletec distributed the policies up to the Appellant, and we were shown an assignment duly effecting that transfer.

20. On 21st September the Appellant resolved to cash the numbered policies, and to instruct Ins.co to transfer the entire encashment proceeds to Holdings in satisfaction of the Appellant's loan liability to Holdings. The company secretary was instructed to give effect to this instruction.

21. We were shown an RBS bank statement of Holdings' account recording payments on 16th October 2005. This account recorded payments made by "Ins.co, reference Hereford" in the amount of £2.0 million. We will refer below to why the payment was said to be for £2.0 million rather than £2.5 million and to the delay between 21st September and 16th October before the money was actually paid to Holdings.

HMRC's criticisms of the steps of the scheme, and some of the observations on the steps made on behalf of the Appellant

22. HMRC first criticised the way in which Holdings indicated to the Appellant the availability of the policies and Mossbank initially offered the 10 policies to the Appellant. At that point, Heletec had not been acquired by the Appellant, and it is noteworthy that the Appellant had merely acknowledged to Holdings "the availability of the policies". We are also absolutely clear that Mr. Smeal, albeit claiming that he did not understand the technical reason why the various steps might generate an allowable tax loss, most certainly knew that it was fundamental to the scheme that the policies should be acquired by Heletec and not initially by the Appellant.

23. HMRC then criticised the terms of the offer of loan by Holdings to the Appellant. This was, as already mentioned, on the very simple basis that it was to be repaid by 31st December, it was to be interest free and unsecured. HMRC suggested that Mr. Smeal, as an experienced businessman, would have realised that this loan was non-commercial, and that he should have expected a far longer loan agreement.

24. HMRC's two most fundamental criticisms were that either "nothing had happened at all", or that if anything had happened, the Appellant itself had directly acquired the policies from Mossbank, obviously by purchase, such that the scheme would have failed for that reason. In the context of these two criticisms we accept that we were not shown any written acceptance, actually by Heletec, of an offer to transfer the policies which had of course been made in any event to the Appellant and not Heletec and we were also not shown any assignment of the policies to Heletec. All that we were shown was the instruction by the Appellant that Holdings should pay £2.5 million to Mossbank, and the endorsement on the policies in favour of Heletec made by Ins.co.

25. We should however record two points made on behalf of the Appellant. The first was that Mr. Smeal said that there was a "community of understanding" between all parties to the effect that all parties clearly appreciated that Heletec was to be acquired by the Appellant; it was then to be duly capitalised by the Appellant, and following that it would be Heletec that purchased the policies. Secondly he said that in business, numerous acceptances and instructions were given orally. In his business as an international meat trader, he had been accustomed to placing orders in which the price payable was in the region of £0.5 billion and that even at that level many deals were far from fully documented. He could not now remember whether notification of Heletec's decision to acquire the policies had been communicated at a meeting or orally in some way, but with the elapse of 10 years since the transactions were implemented, this was hardly surprising. He certainly asserted that any gaps in the documentation would have been bridged by oral acceptances, notifications and instructions.

26. HMRC next placed considerable emphasis on the fact that Mr. Smeal's letters, in effecting the steps of the scheme, had been on personal notepaper. Prior to seeing the letters we envisaged hand-written letters without reference to the involvement of the companies. In the event all that HMRC actually meant was that the letters had, we assumed, been prepared (hardly surprisingly) by Montpelier, but they were nevertheless accurately typed and they bore the correct company name and address of the Appellant. We regarded claims that these letters involved breaches of the Companies Acts to be irrelevant. The only conceivable technical failure might have been that the notepaper may not have recorded the Appellant's registration number, should that be a requirement of the Companies Acts, but beyond that it was irrelevant, and not disputed, that the letters written by the Appellant all recorded its name and full address. They had also all been signed personally, in ink, by Mr. Smeal.

27. HMRC drew our attention to three other factors that they criticised.

28. The first was that there was a typing slip in relation to one of the 10 policies and a date in relation to it. Mr. Smeal confessed that he had missed this point. Without addressing at this point all our observations in relation to the efficacy of the scheme steps, we consider the typing slip, and the fact that Mr. Smeal failed to spot that to be of little significance.

29. The second point related to the fact that, although the RBS bank statement seemed to confirm that genuine payment had been made by Ins.co to Holdings, the repayments made to Holdings consisted of only £2.0 million, not £2.5 million, and the payments were not made until the October date. In relation to these criticisms, we were told that the fact that £0.5 million was not repaid to Holdings was because Holdings had owed that amount to Ins.co, and Ins.co's debt for the balance of the £2.5 million and its right to receive £0.5 million from Holdings were set off against each other. No comment was made in relation to the delay of a month in effecting the loan repayment, but we rather surmised that, as between the two affiliated companies, the delay was not that significant. The legal position would still have been that by having directed the payment of the redemption amount to Holdings, and by Holdings' implicit acceptance of that, the Appellant's liability would indeed have been extinguished.

30. HMRC's third point was that the way in which the Appellant immediately sought to redeem the policies and apply the proceeds in repaying the loan once the policies were distributed up to the Appellant was uncommercial. The Appellant could have retained the benefit of the interest-free loan until 31 December 2005, and thus retained the supplemental payments on the policies without having to pay any interest on the loan. Mr. Smeal explained that the reason the repayment date was set at 31 December was to cater for the eventuality that something might delay the implementation steps, but nevertheless both parties really contemplated that once the policies were held by the Appellant, the policies would be redeemed and the loan repaid.

Some consideration of whether the actual steps of the scheme would have been held to be effective, such in particular that the policies would have been held to have been purchased by Heletec, had this been disputed

31. We must preface our observations on the issue of whether the actual scheme steps would have achieved their object with three preliminary points.

32. First, in addition to it being unnecessary for us actually to decide this point, we do not have the full information that we would have required had it formally been necessary for us to decide this issue. HMRC acknowledged that no claim of negligence was based in any way on the Appellant's failure to anticipate the actual *Drummond* decision, or indeed on the issue of whether the policies ranked as insurance policies and chargeable assets for capital gains purposes, because the taxpayer cannot have been expected to take a view in relation to those points. If we had had to rule on the actual efficacy of the scheme steps, however, we would have had to satisfy ourselves that the policies really existed, that the premiums on them had been paid up by Mossbank (as to which there was no evidence) and other such "behind the scenes" issues. We consider that we can realistically ignore these features because they will not have been anything that Mr. Smeal or the Appellant could possibly have been expected to question and check, unless they had grounds for suspecting that the whole scheme was fraudulent. For various reasons we will dismiss that concern below.

33. The second point that we make is that we do accept that the documentation in this case was very badly prepared. The way in which the draw-down of the loan was elided with the subscription

of the shares of Heletec at a premium and the resultant contribution to Heletec of the benefit, but not the liability under the Holdings' loan (recorded in paragraph 16 above) was very badly documented, and other steps were skimpily documented. This is not, however, to say that if there had there been some dispute between the parties as to what had happened, or whether anything had happened at all, any court would have said that, because the documentation was poor, there was no need to seek to analyse and then respect the parties' intentions.

34. That takes us to the third point which relates to HMRC's criticism that they normally see immaculate documentation when artificial schemes have been marketed by promoters because the promoters will know that HMRC will be scrutinising the steps and endeavouring to undermine the schemes for failures to implement the transactions properly. In this case, HMRC say, quite rightly, that the documentation was far short of the normal standard seen. It certainly was. This, however, does not mean that the documentation was necessarily ineffective. The relevant question is what construction a court would have put on it, had a court been required to interpret the documentation, address any other evidence, and reach a conclusion as to what had actually happened.

35. Dealing now with points raised by HMRC in declining order of significance, we do not accept that "nothing actually happened". We were told, and Mr. Smeal had known from the outset, that RBS were advancing a short term loan to Holdings to enable Holdings to play its role in the scheme. We must presume that Holdings paid Mossbank £2.5 million, when instructed to do so by the Appellant, and we also accept that on the redemption of the policies, Ins.co made the payments directly to Holdings, thereby discharging the Appellant's loan liability to Holdings. On the basis that those steps all occurred, we accept that we have yet to consider which company acquired the policies, but certainly one or other of the Appellant or Heletec had actually acquired the policies.

36. More stress was put by HMRC on the proposition that, because Mossbank offered the policies to the Appellant and not Heletec, and it was the Appellant that directed Holdings to pay £2.5 million to Mossbank, the better construction might be that it was the Appellant that had purchased the policies from Mossbank.

37. This, however, disregards the fact that all parties, very clearly including Mr. Smeal, appreciated that the policies were intended to be acquired by Heletec and it ignores the whole acquisition, existence and capitalisation of Heletec. We accept that the resolutions of the Appellant and Heletec recorded in paragraphs 16 and 17 above (particularly that of the Appellant) were badly worded but they cannot be interpreted to have had any other effect than that the Appellant subscribed the shares of Heletec and contributed £2.5 million to Heletec. Once it is accepted that Heletec was capitalised, no other meaning can be given to the precise wording that we quoted in paragraph 16 above other than that Heletec had the benefit of the loan but not the liability under it. Any other construction (for instance that the rights and liability under the loan were all assigned to Heletec) would be inconceivable since it would not result in the capitalisation of Heletec, as was obviously intended, and it would anyway have been legally ineffective, absent consent by Holdings. We consider that the Appellant did acquire and capitalise Heletec, and that this had to mean that the benefit of the loan (or indeed anything acquired with the benefit of that loan) belonged to Heletec. Once, in other words, the Appellant is held to have capitalised Heletec by assigning to it the benefit of the loan, the Appellant cannot spend the borrowed money twice by buying for its own account the policies for £2.5 million. Even before observing that the same Director and Secretary effected the two critical resolutions referred to in paragraphs 16 and 17 above, the latter of which certainly resolved that Heletec should apply the benefit of its capitalisation (i.e. the rights under the loan) to purchase the policies from Mossbank, no other interpretation can fit the facts.

38. We conclude that, notwithstanding the very poor documentation, the right and only analysis is that the policies were acquired by Heletec. We accept that we do not now know for certain how Heletec's resolution to accept Mossbank's offer, initially made to the Appellant, was communicated to Mossbank. We accept Mr. Smeal's evidence that the great likelihood is that this was communicated orally, or possibly all the parties were at the same meeting, and of course so far as Mossbank was concerned, the effect of the Appellant's direction to Holdings to pay £2.5 million to Mossbank meant that Mossbank's counterparty had performed its side of the purchase contract.

39. HMRC also placed considerable significance on the feature that no money ever flowed into or indeed out of either the Appellant's or Heletec's bank accounts. We were never absolutely clear whether HMRC's objection was on the basis that money was meant to have been paid at the various steps, and the payment steps were just omitted, or whether HMRC objected to the way in which the payment steps were deliberately collapsed together, such that Holdings' payment to Mossbank achieved the triple purpose of satisfying Holdings liability to make the loan to the Appellant, the Appellant's commitment to capitalise Heletec, and Heletec's resolution to purchase the policies. In any event our conclusion is that this collapsing of the payment steps (and the same on the redemption of the policies) was clearly intended by all parties. We consider that it was somewhat provocative, and we do not know why the parties chose to operate in this way. They did, however, and Mr. Smeal certainly appreciated that this was intended. In other words he could not have concluded that something must have gone seriously amiss when no money flowed into or out of the bank accounts of his two relevant companies, because he knew that this was never intended.

40. At the more trivial level, HMRC criticised the over simple terms of the loan and said that any businessman would have realised that the loan was non-commercial. Mr. Smeal should also have expected to see a much longer loan agreement. We disagree. The actual terms set were absolutely all that was needed. We would have concluded that the terms of the loan had been embroidered with ineffective "window-dressing" had other terms been included in a longer loan agreement.

41. We also reject HMRC's claim that had Mr. Smeal been acting commercially, the Appellant would have retained the policies, and the growth on them, until 31 December, and redeemed them at the latest point for repaying the interest-free loan. We accept Mr. Smeal's evidence that we recorded in paragraph 30 above.

42. There was little contention during the hearing to the effect that the Montpelier scheme might have been challenged on the ground that because all the steps occurred on such a tight time scale, and in a manner so clearly designed just to generate a tax loss, the scheme might have been challenged on that ground. It was possibly reminiscent of the judicial comment that "and then they had lunch". In this context, however, we find it extremely difficult to believe that there could have been much more reality to any of the similar schemes promoted by others. Surely it cannot have been asserted that any participant in any of these schemes purchased one of these policies and later passed it to a subsequent holder in some non-purchase fashion because they genuinely wished to hold such a policy. We cannot therefore believe that the manifestly artificial way in which the scheme was implemented could have occasioned some basis of challenge, or at any rate that if it did, then the same must surely have applied to the equally artificial, if better documented, other schemes, in relation to which negligence was not asserted, and no penalties imposed.

43. HMRC's criticisms of letters written by the Appellant, and (as he said) signed in ink by Mr. Smeal, along the lines that they did not have any Appellant logo at the top or the registered number of

the company at the bottom, such that the Appellant breached the terms of the Companies Acts, were not relevant.

The crucial negligence issue

44. HMRC's claim was that the Appellant had been negligent in submitting its tax return as it did. It should either have sought further independent advice in relation to the efficacy of the scheme, or it should have questioned some of the terms in the documentation or in some way its tax return should have reflected the expectation that the scheme would fail on implementation grounds. HMRC made no claim that any participant should have anticipated the decision in *Drummond*, or that possibly the relevant policies might have for some reason been unsuitable (which the Appellant and Montpelier anyway disputed). It was accepted that non-professional taxpayers could not have had any views in relation to those matters. The only claim to sustain the challenge of negligence related to the perceived implementation errors and claimed defects in the Montpelier scheme.

45. The test of negligence is essentially whether the Appellant failed to do something that a reasonable taxpayer would have done, or did something that no reasonable taxpayer would have done.

46. We must obviously address the question just posed by looking at all the circumstances pertinent to the present Appellant. It is, however, curious that of the 134 clients that had implemented the scheme, that did not escape penalties by having died, emigrated or become insolvent, all, bar the possible exception of one, were subjected to penalties. When the test of reasonable conduct must indicate on these facts that all 134 or 133 participants uniformly had standards that fell below that of the reasonable man, the obvious question must be posed as to whether the standards of the reasonable man have been pitched too high. We will, however, ignore that point and now consider the conduct and approach of the Appellant and Mr. Smeal.

47. In our judgment, Mr. Smeal was transparently honest, meticulous and diligent. He accepted that he had no way of knowing whether the proposed scheme would succeed, in terms of its technical tax requirement. In the presence of his normal, non-tax-specialist accountant, however, he was taken through all the steps in the scheme and he thoroughly understood the required transaction steps. He quite clearly understood that Heletec had to be formed and capitalised; that it was Heletec that had to take the initial assignment of the policies from Mossbank, and that the policies had to be distributed up to the Appellant, by way of distribution or return of capital. He was shown, and read, a tax opinion from David Ewart, and while his normal accountant accepted that the chances of success were something on which she could volunteer no opinion, she did say that she fully understood what was proposed, and why it was asserted that the scheme might generate a capital loss.

48. Contrary to the evident views of HMRC, Mr. Smeal had considerable faith in Montpelier. He had used them back in 2002, and while HMRC contended that he should have been cautious in 2005 because the 2002 scheme had failed, he pointed out that the 2002 scheme had not been questioned until well after 2005, and that the risk of failure currently hinged on retrospective legislation and the outcome of a claim being made by another participant in the European Court of Human Rights. The presently relevant point is that his past experience of Montpelier had been highly satisfactory, he appeared still to retain that opinion and he said that his particular contact was an impressive professional. There was in other words no belief or concern that he was dealing with a firm of poor repute. On this ground we conclude that nobody could have expected Mr. Smeal or the Appellant to seek to verify any of the "behind the scenes" steps in the transactions. Equally, in considering the documentation, Mr. Smeal was entitled to think that his professional adviser would have prepared

adequate documentation, particularly if it seemed to him to be effecting the steps that he expected to be implemented.

49. In addition to the discussions with Montpelier, Mr. Smeal researched the financial press and the internet and concluded that the Capital Redemption Policy scheme was regarded as a widely-used tax planning tool, and, as mentioned above, one that was being marketed also by highly reputable firms.

50. Prior to implementing the scheme, Mr. Smeal was shown the licence granted to Ins.co to conduct insurance business, and he was told (seemingly correctly) that RBS had advanced a short term loan to finance the scheme. We were not told how Mossbank had financed the payment of the premiums on the various policies (assuming indeed that Mossbank itself was the initial holder), but it seems obvious that if RBS advanced the funds required to implement the scheme that actual money would have been paid to Mossbank for the assignment of the policies. Mr. Smeal was therefore aware of third party facts that rendered the HMRC claim that "nothing had happened" particularly improbable.

51. In relation to a record of a conversation with Mrs. Duffy, in which she had recorded that he had said that all the documents had been signed at one session, he said that this is not what he had said. He said that he had signed one pile of documents at one meeting and thought that these had been the various insurance policies. He rejected any possibility that documents appearing to be signed by him had not been signed by him personally, in ink, and he rejected the possibility that he would have signed documents at wrong times.

52. He placed some reliance on the fact that in the business world, when two parties, or various related companies on two sides of a deal, reached a common understanding and all knew what was intended, it was relevant to take that "community of understanding" into account when both interpreting documents, the legal effect of documents and the supposition (10 years after the transactions had been implemented) that certain confirmations, notifications and acceptances might have been communicated orally or perhaps at meetings. We have already mentioned that in his business life, he had been accustomed to dealing fairly informally with deals involving £0.5 billion. We were rather inclined to think that his basis for comparing the efficacy of the transaction steps in this case by reference to other "real world business transactions" was rather more relevant than HMRC's comparison between Montpelier's documentation and that of other promoters that we agree would usually be better prepared, and indeed specifically prepared to impress HMRC.

53. We are not remotely saying that a scheme cannot fail for implementation failures. It plainly can do, and many have done. We even readily accept that some of the drafting of the documents in the present scheme left much to be desired. Properly interpreted, however, by reference to the only cogent interpretation of the steps that we consider did actually occur, and paying regard to the clearly understood expectations of all parties that all knew precisely what was to happen, we consider that Mr. Smeal was more than entitled to think, as he did, that this scheme would operate as all expected, and that its success would depend on the judgment of the courts.

Our conclusion in relation to negligence

54. Our immediate and very much joint judgment in this case was that the Appellant had not been negligent in submitting its tax return as it did, and we felt sufficiently clear of this conclusion to give our decision orally at the end of the hearing. We now formally confirm that decision.

Conclusions in relation to quantum of penalty

55. This issue does not arise unless our decision is overturned on appeal, but we should still address it. In relation to the maximum mitigation of penalties of 20% for disclosure, 40% for co-operation and 20% for seriousness, the penalty of 25% assessed on the Appellant was based on reductions of 15% for disclosure, 40% for co-operation and 20% for size and seriousness. Obviously our judgment in relation to these percentages is entirely influenced by our views that render this whole issue irrelevant. If, in other words, we are right to say that there was no negligence in preparing the Appellant's tax return by claiming the artificial loss and quoting the DOTAS number of the scheme on the basis of which the loss was claimed, it obviously follows that we would have granted the full 20% mitigation for disclosure. And since a penalty should not be assessed for implementing a legal scheme with disclosure of the relevant DOTAS number, we would have given full mitigation for seriousness.

56. Even were we wrong on the fundamental point, we believe that the Appellant was completely open and cooperative at all times. Complaints that he had to obtain the documentation from Montpelier, which then provided the documents, did not illustrate any want of disclosure or cooperation.

57. We would accordingly have given full mitigation for disclosure and cooperation, and were we wrong in relation to the negligence issue, we still consider that a 10% factor for seriousness would have been more appropriate than 20%. In the way that no penalties were exacted from participants in schemes promoted by KPMG, Grant Thornton and others, this illustrates that there should be no penalty for honestly implementing a legal scheme, with no element of evasion, and with full provision of the DOTAS number. On the basis that our conclusion in relation to negligence, that is negligence solely related to perceived implementation failures, is wrong, we still consider that 30% mitigation should have been given, leading to an overall penalty of 10%, This view is perhaps supported by the fact that if the conduct of every single participant in the schemes who has neither died, emigrated nor become insolvent, has fallen below the standards required of the reasonable man, that failing must have been exceptionally marginal.

Right of Appeal

58. 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.

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASED DATE: 16 February 2015