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An Artificial Solution to an Artificial Problem – Tax Avoidance and the *Dukeries* Case

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The recent case of Dukeries Healthcare Ltd -v- Bay Trust International Ltd [2021] EWHC 2086 (Ch) has highlighted an issue that practitioners who are seeking to avoid or set aside a settlement often come across, but where until now there are no authorities:-

> *Whether a court can 'deem' or impose an objective assessment that a settlor has deliberately run a risk of mistake, in particular in cases of 'artificial tax avoidance'.*

In doing so this is the first case (at least in England) that expressly gets to grips with Lord Walker's famous yet Delphic comment in *Pitt v Holt* [2013] 2 AC 108 at paragraph 135 concerning the availability of relief in cases of "*artificial tax avoidance*".

The Facts:

Mr Levack is a successful self-made businessman in the field of nursing homes and private hospitals. He owned several companies outright and had a major shareholding in another. In around 2010 there was a possibility of selling his companies (which never came to fruition) and he sought tax advice on how to mitigate CGT. Unfortunately for him his bank manager recommended Mr Paul Baxendale-Walker to him as a tax adviser. This was in the period that Mr Baxendale-Walker was touting his Rangers FC style "remuneration trust" as a way to avoid income tax.

Mr Levack, together with his usual financial adviser, met with Mr Baxendale-Walker, who talked about CGT savings – and then, on hearing how successful Mr Levack was generally, essentially sold them on the idea of a 'remuneration trust' which was an 'employee benefit trust' ("EBT") for various tax purposes. There are lots of details to this, but the central idea was that although Mr Levack and his family were 'excluded beneficiaries' under the trusts' deeds, in reality:

- The trusts could lend Mr Levack money which would be free of income tax liabilities.
- Then, when Mr Levack was dead the outstanding liability would reduce his estate for IHT purposes and his family could now be beneficiaries of the trusts, again free of IHT and income tax.

There were, perhaps unsurprisingly, several problems with this structure. The big one was that either:

- Him taking loans and his family benefitting in the future meant the trusts were not EBTs; or
- He and his family could not take **any** benefits from them.

So either seriously bad tax consequences, or he had accidentally given millions of pounds to strangers.

Of course, HMRC ultimately challenged the tax status of the trusts, and sent assessments on the basis that they were not EBTs. Mr Levack and his companies then sought to (inter alia) set aside the settlements on the basis of mistake as to both (i) tax, and (ii) his family could not benefit.

The Judgment:

The judgment deals with the issue of mistake in two broad ways:

- First –it concludes that there was no evidence of mistake, because Mr Levack's evidence was so poor that he rejected his evidence in relation to his understanding of the tax position; and
- Secondly - in any case, the judge would have found that the settlors (Mr Levack and his companies) should be taken to have undertaken the risk of mistake.

There is permission to appeal on another issue in the case, and permission to appeal on both these issues in relation to mistake is currently being sought. The first (evidence of mistake) is not relevant to this article, but the second (settlors should be taken to have undertaken the risk) is.

Objectively deeming whether the settlor was running a risk and "artificial tax avoidance":

The core of the judgment on this issue is at paragraph 91. Having listed at paragraph 90 various factors put forward by HMRC as characteristics of "*artificial tax avoidance*", the judge concluded that:

> *91. It seems to me that there is no real answer to these factors. They illustrate that the remuneration Trusts are properly regarded as artificial tax avoidance. This conclusion has relevance to the application of Lord Walker's guidance in paragraph [135] of Pitt v Holt.* ***It is open to the court to decide that Mr Levack must be taken to accept the risk that the schemes would prove to be ineffective. As it seems to me, Lord Walker was saying that the court may impose an objective judgment if there is artificial tax avoidance, regardless of whether there was as a matter of subjective fact, an acceptance of the risk of failure.*** *This is the distinction that is made at factor (4) between the settlor deliberately running the risk, and being taken to have run the risk, of being wrong."* (Emphasis added.)

Leaving aside the philosophical question of whether tax avoidance is ever not artificial, this is where the author of this article thinks that the judgment got it seriously wrong.

There are two statements by Lord Walker in *Pitt v Holt*. On whether a settlor should be "*taken to have run the risk of being wrong*". First, at paragraph 114:

> *"It does not matter if the mistake is due to carelessness on the part of the person making the voluntary disposition, unless the circumstances are such as to show that he deliberately ran the risk, or must be taken to have run the risk, of being wrong. (There is an illuminating discussion of this point in Lord Hoffmann's speech in Deutsche Morgan Grenfell Group plc v Inland Revenue Comrs [2007] 1 AC 558, paras 24-30.)"*

And secondly at paragraph 135:

> *135. .... In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary relief should be refused on grounds of public policy. Since the seminal decision of the House of Lords in WT Ramsay Ltd v Inland Revenue Comrs [1982] AC 300 there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures. But it is unnecessary to consider that further on these appeals."*

One can clearly see why a court's discretion should be impacted upon by public policy. It is plainly a 'relevant consideration', to use the language of private discretions. However, whilst there might be a time when the courts say that public policy means that relief from mistake should not be available for 'artificial tax avoidance' that time has yet to come. Even in Dukeries the judge did not go that far. And to be fair it is worth noting that HMRC expressly decried any such argument in this case – they ran it on a 'no mistake' basis, rather than a 'no relief' basis.

So that leaves one with the argument that the courts should approach the question of whether a settlor 'ran the risk' on an 'objective' basis by reference to the nature of the transaction. Should the courts ignore the actual evidence and impose a finding – amounting to a legal fiction – that somebody ran a risk just because of the nature of the transaction and public policy? The possibility seems unlikely to start with – legal fictions generally not being encouraged in the modern world, let alone created *de novo*. Furthermore, just reading the words of paragraphs 114 and 135 it is relatively clear that Lord Walker was distinguishing between (i) circumstances where settlors "*acting on supposedly expert advice*" should be taken to have run a risk, and (ii) refusing relief on the basis of public policy. If this is a fair reading of Lord Walker's judgment, then his analysis was not in this respect concerned with public policy, but rather simply with whether "*unless the circumstances are such as to show that he deliberately ran the risk, or must be taken to have run the risk, of being wrong*".

Finally, assuming that analysis is correct, then in turn if one looks at Lord Hoffmann's speech in *Deutsche Morgan Grenfell Group plc v IRC* [2007] 1 AC 558, it is relatively clear that this was not a statement of policy that there should be a deemed risk running in certain categories of case – but rather it was a factual statement that in some circumstances it is appropriate to conclude that there was a deliberate undertaking of risk. In particular, at paragraph 27 of that judgment Lord Hoffman opens his analysis with the statement "*Likewise, the circumstances in which a payment is made may show that the person who made the payment took the risk that, if the question was fully litigated, it might turn out that he did not owe the money….*" before then going on to give examples of such circumstances. Accordingly this should not be a case of objectively imposing a determination of risk running, but rather analysing whether on the (indirect) evidence it is possible to determine the settlor's state of mind as being one of running a risk.

The current problem is this – if *Dukeries* is not successfully appealed it is an authority that such deeming or objective imposition of running the risk is available and appropriate for 'artificial tax avoidance' schemes. How strong an authority is up for debate, given that it was a decision of a Chancery Master, rather than a fully High Court Judge; see Michael Ashdown's article in Wilberforce Chambers' Private Client eYearbook 2022. But it will at the very least bind the First Tier Tribunal and be persuasive in the Upper Tribunal. But to the extent that it is correct, then it appears to the author that this could in effect defeat any possibility of setting aside transactions which were entered into primarily or solely for tax purposes on the basis of mistake (at least as to tax).

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