[2018] UKFTT 141 (TC)

# TC06394

**Appeal number: TC/2013/05016**
**TC/2013/08077, 08075, 08074, 08068**

***PROCEDURE – application for disclosure – application to bar HMRC – applications refused***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**COLMAN, KEY, SCHILLING & WALTON PARTNERSHIP and others** — **Appellant**

**- and -**

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

**TRIBUNAL: JUDGE JONATHAN RICHARDS**

**Sitting in public at Taylor House, Rosebery Avenue, London on 19 February 2018**

**Rebecca Murray, instructed by Colman Coyle Limited for the Appellants**

**Timothy Brennan QC and Imran Afzal, instructed by the General Counsel and Solicitor for HM Revenue & Customs for the Respondents**

DECISION

1. The appellants have made two interlocutory applications to the Tribunal in connection with their respective appeals:

(1) First, they have applied for a direction that HMRC be barred from pursuing their case in this appeal.

(2) Second, they have applied for a direction that HMRC disclose certain documents and information.

## Evidence

2. For the appellants, I had evidence from Mr Warren Jay Colman, a partner in the Partnership, and Mr Brennan cross-examined him. I was satisfied that Mr Colman was a reliable and honest witness.

3. For HMRC I had evidence from Officer Fraser Jackson and Officer Stuart Condie, both officers of HMRC. Ms Murray did not challenge their evidence in cross-examination. I have therefore accepted their evidence.

## Facts

4. I will make some findings of fact that are limited to those necessary to decide the interlocutory applications before me. By way of background, Colman, Key, Schilling & Walton Partnership contends that it was, in the 2001-02 tax year a partnership engaged in a trade of the distribution of films. HMRC deny that it carried on any trade. More generally, HMRC do not accept that the averred partnership consisted of persons carrying on a business in common with a view to profit (and so they do not accept that it was even a partnership as a matter of English law). For shorthand, I will refer to the averred partnership as the "Partnership" and its members as "Partners", but in doing so, I should not be taken as deciding the issue one way or the other.

5. In its partnership return for 2001-02, the Partnership claimed that it made a loss of around £10.7m in its trade and the partners in the Partnership claimed to set their respective shares of that loss off against other taxable income. HMRC opened an enquiry into the partnership return on 5 June 2003. HMRC also opened an enquiry into the Partners' tax returns. Officer Condie, together with a team of other HMRC officers, was largely responsible for the conduct of HMRC's enquiries.

6. When establishing the Partnership and entering into transactions involving the acquisition of films, the appellants relied heavily on advice from Mr Terry Potter (a partner in the firm of Sefton Potter who had an extensive film finance practice). Mr Potter was also central to the appellants' efforts in responding to HMRC's enquiries as he had a close involvement with the relevant transactions and had access to relevant documentation.

7. I accept that, until 2013 when HMRC issued their closure notices, Mr Colman had a genuine belief that HMRC could be persuaded to drop their enquiries if the appellants could provide evidence that the price the Partnership paid to acquire the films was the true market value of those films. I have inferred that this belief must have been shared

by Mr Potter because, until around 2013, Mr Potter and the appellants focused their efforts on gathering information relevant to their dispute with HMRC on matters relating to the valuation of the films.

8. Therefore, Mr Colman and Mr Potter formed a genuine belief that HMRC's enquiries were limited to questions of valuation (and the related question of whether, when the Partnership paid money ostensibly to acquire rights in respect of films, it was really making a payment in connection with a financial security issued as part of a circular flow of funds). However, HMRC did not give them an express or unequivocal assurance to this effect and did not enter into any binding contract with the appellants restricting the scope of HMRC's enquiries. For his part, Officer Condie had a genuine belief that HMRC's enquiries were not limited to questions of valuation, but that his enquiries into valuation were part of a wider enquiry into the commerciality or otherwise of the Partnership's operations.

9. Because of the belief of the appellants and Mr Potter referred to at [8], no significant attempt was made to gather together documents that might demonstrate that the Partnership was trading until 2015, after the Partnership received HMRC's closure notice in 2013. By that time, as noted below, Mr Potter was under criminal investigation and HMRC had seized a large quantity of documentation relating to the Partnership.

10. In February 2012, HMRC executed search warrants at 18 sets of premises that had some connection with Mr Potter. In particular, HMRC visited the private home of Mr Potter's personal assistant, Ms Murphy, and most of the information seized came from her address. None of the premises visited were occupied or under the control of Mr Potter himself. The documents that HMRC seized consisted of both hard copy documentation (running to 50 bankers' boxes of material) and electronic documentation. Although Mr Potter was not suspected of criminal conduct in relation to the Partnership's activities, since HMRC were seizing large quantities of documents, inevitably some of those seized related to the Partnership.

11. HMRC engaged a third-party forensics firm ("CCL") to create digital images of both the hard copy documentation and the electronic documentation that was seized and to store the digital images electronically. The digital information ran to some 17 terabytes. Mr Potter was subsequently charged with criminal offences (unrelated to the activities of the Partnership) and the digital information was used for the purposes of Mr Potter's criminal trial (including for the purposes of providing disclosure to Mr Potter's defence team). In December 2015, Mr Potter was sentenced to 8 years' imprisonment following his conviction on various counts of cheating the public revenue (unconnected with the activities of the Partnership).

12. Officer Condie said, in unchallenged evidence, that all the digital information that CCL had stored (including the scanned versions of the hard copy documentation originally in the 50 bankers' boxes) was, in principle, searchable. Moreover, it was possible to search the underlying documents (and not just the names that individual documents had been given for the purposes of electronic indexing). In 2016, HMRC had specifically verified that point with CCL. There were, however, exceptions to that:

handwritten documents that had been scanned in would not be searchable. In addition, where the document scanned in was a poor-quality copy, the ability to search that document might be compromised. A graphic example of the ability to search the underlying documents came from the fact that the activities of a "Mr Edinburgh" were relevant to the criminal trial and when HMRC sought to search the documentation that they had for his name, they produced large numbers of hits relating to the city of Edinburgh.

13. The appellants were dissatisfied with the length of time that HMRC's enquiries were taking and they successfully applied for a closure notice. On 8 April 2013, HMRC issued a closure notice relating to the Partnership tax return disallowing the entirety of the loss that the Partnership had claimed on the grounds that:

> (1) The Partnership was not carrying on a trade or business.
>
> (2) The expenditure incurred by the Partnership was not incurred wholly and exclusively for the purposes of its trade (or alternatively that part of it was not incurred "wholly and exclusively".

14. Also on 8 April 2013, HMRC issued closure notices disallowing the Partners' share of the Partnership's losses. Both the Partnership and Partners appealed against HMRC's closure notices, and in due course those appeals were notified to the Tribunal.

15. HMRC's closure notices made it clear to the appellants that HMRC were not simply challenging the Partnership's loss by reference to questions of valuation and that the appellants needed to produce evidence that, among other matters, the Partnership was carrying on a trade or business if they were to succeed in their dispute. Mr Colman's evidence was that the appellants did not start gathering together evidence on these issues until 2015 and he was pressed in cross-examination as to the reason for that delay. I have concluded that the appellants did not start the process of gathering evidence until after they received HMRC's Statement of Case in the Tribunal proceedings, which was served on 21 March 2014. The appellants and Mr Potter went through HMRC's Statement of Case line by line and divided up responsibility for responding to the points that HMRC made. Given Mr Potter's close involvement with the transactions and access to documents, he was allocated the lion's share of the responsibilities. Until Mr Potter was imprisoned, in 2015, the appellants did not consider that they would need to find documents themselves.

16. I accept that, after Mr Potter was imprisoned, Mr Colman took a number of steps to obtain documents from other sources. For example, he contacted Mr Potter's former assistant (Michaela Rees) but could recover only one relevant document from her. He also contacted Ms Murphy, Mr Potter's former personal assistant, but she was unable to help partly because she had been charged with criminal offences together with Mr Potter and, although she was not convicted, her mental state following the proceedings was fragile. He also contacted lawyers who had advised on the acquisition of the films as well as counterparties from whom the Partnership had acquired films.

17. Mr Colman described his own efforts to obtain documents after Mr Potter's conviction as "Herculean". That is a strong term which may overstate matters slightly,

but overall I am quite satisfied that, after Mr Potter was sent to prison in 2015, Mr Colman was assiduous in his attempts to track down documents that might be relevant to the appellants' appeals. I do not consider, however, that a very good reason has been given why the appellants did not take steps to try to gather documents relevant to the Partnership's trading status in good time after receiving HMRC's closure notice in April 2013. When Mr Potter saw HMRC's closure notice he should have realised that the appellants needed to gather evidence on the trading issue, but that HMRC had seized a large quantity of relevant documents in 2012. Some urgency was indicated and I do not consider that it was reasonable to delay starting the exercise of trying to gather together documents until HMRC served their Statement of Case (nearly a year after the closure notice was issued). The appellants had the burden of proof on the "trading issue" and did not need to wait for an articulation of HMRC's position before they could gather together their documentary evidence relevant to that issue.

18. In parallel with Mr Colman's efforts, the appellants were also seeking to obtain documents from HMRC. In September 2015, the Partnership's advisers wrote to HMRC asking them to provide a full list of all documentation relevant to the Partnership (whether in electronic or hard copy form) that they had seized as described at [10]. HMRC responded by saying that they had previously provided the Partnership's former advisers (Aquarius) copies of documents that Aquarius considered were missing from their files and that, having performed that exercise, they did not propose to provide the list of documents requested.

19. Further correspondence ensued. On 17 February 2016, the Partnership's advisers wrote to HMRC stating that information and documents seized from Sefton Potter (Mr Potter's accounting firm) and from Aquarius was held as agent for the Partnership and that accordingly, the Partnership was entitled to the return of that information as of right. HMRC did not agree that the Partnership was entitled to the information and, on 13 May 2016, the Partnership made an application to the Tribunal for disclosure of documents.

20. The application for disclosure was listed to be heard in November 2016. In advance of that application, HMRC and the appellants continued to correspond on the question of disclosure. In the course of that correspondence, HMRC confirmed that some of the material that they held that was stored electronically was organised into folders named "CKSW" and "CKSW correspondence". That resulted in the parties agreeing to compromise the application for disclosure in the following way:

> (1) HMRC would conduct an electronic search of material that they had using search terms that the appellants provided;
>
> (2) HMRC would provide copies of documents in the "CKSW" and "CKSW Correspondence" folders.
>
> (3) The appellants would reimburse HMRC their costs.

21. Officer Condie's unchallenged evidence was that CCL initially performed the search described at [20]. That produced a list of "hits" that HMRC then reviewed, removing documents that they considered had no relevance to the appellants and redacting documents that, for example, contained information on other taxpayers.

Following review and redaction, that material was provided to the appellants. Officer Condie accepted, however, that HMRC never obtained access to all of Mr Potter's documents: for example, Mr Potter had private computer systems in Monaco and France which HMRC have never had access to. It follows that HMRC did not (and could not) provide the appellants with a complete set of documents relevant to the appellants' dispute with HMRC.

22. The appellants were dissatisfied with amount of disclosure that they obtained and, on 1 June 2017, they renewed their application for disclosure to the Tribunal.

## The barring application

*The parties' submissions*

23. The appellants argue that HMRC made it clear during their lengthy enquiry that the only issues HMRC were disputing were (i) whether films that the Partnership acquired truly were worth the amount that the Partnership had spent on them; and (ii) whether the Partnership truly did spend money acquiring films as HMRC were concerned that the money in question had actually been incurred for the purpose of acquiring a financial security pursuant to what it regarded as circular flows of cash connected to the Partnership's finance arrangements.

24. The appellants argue that they have suffered prejudice as a result of HMRC raising issues surrounding the nature of the Partnership's trade or business in the closure notice that had not been adequately trailed during HMRC's enquiries. The closure notices (both in relation to the Partnership's tax return and the tax returns of the Partners) were issued at the end of a lengthy enquiry. Had the appellants realised that the additional issues were in dispute during the enquiry they could have gathered information and evidence from sales agents who acted for the partnership about their activities. However, by the time the enquiry closed in April 2013, it was far too late to do so. The appellants' difficulties were, they say, compounded both by Mr Potter's imprisonment and HMRC's seizure of documents.

25. In their application to bar HMRC, the appellants argued that the Tribunal should exercise its case management powers set out in Rule 5 of the Tribunal Rules, in accordance with the overriding objective set out in Rule 2 of the Tribunal Rules, to restrict HMRC from advancing a case otherwise than on the two issues set out at [23]. At the hearing Ms Murray, counsel for the appellants, put matters somewhat differently. She accepted that the Tribunal's power to bar HMRC could come only from Rule 8 of the Tribunal Rules. However, she argued that giving the Tribunal Rules a purposive construction in accordance with overriding objective set out in Rule 2, the requirement of Rule 8(3)(b) of the Tribunal Rules was met since HMRC's act of issuing closure notices to the appellants which referred to issues not raised during enquiry resulted in HMRC failing to "co-operate with the Tribunal to such an extent that the Tribunal cannot deal with the proceedings fairly and justly". She acknowledged that this was a "difficult submission". However, given that the overriding objective set out in Rule 2 of the Tribunal Rules is to deal with cases fairly and justly, she submitted that her approach to Rule 8(3)(b) was warranted.

26. Mr Brennan for HMRC submitted that Ms Murray's suggested application of Rule 8(3)(b) was not just "difficult", but unarguable. As well as making the point that the Tribunal was not involved when HMRC issued their closure notices, he submitted that the Tribunal had no jurisdiction to consider complaints from taxpayers as to the grounds to which HMRC refer in closure notices that they issue; the Tribunal's sole power is to consider, in accordance with s50(6) of the Taxes Management Act 1970, whether the closure notices overcharged the appellants or not. In any event, he argued that the appellants could have no expectation, reasonable or otherwise, that any dispute before the Tribunal would be limited to the issues referred to at [23]. The valuation and other issues were simply aspects of a wider enquiry into the commerciality of the Partnership's activities.

*Discussion and conclusion*

27. Ms Murray accepted that the Tribunal's power to bar HMRC proceedings can only come, in the circumstances of this appeal, from Rule 8(3)(b) of the Tribunal Rules, which provides as follows:

> (3) The Tribunal may strike out the whole or a part of the proceedings if--
>
> (a) …
>
> (b) the appellant has failed to co-operate with the Tribunal to such an extent that the Tribunal cannot deal with the proceedings fairly and justly[1]

28. A necessary precondition to the application of Rule 8(3)(b) is that there has been a failure to co-operate with the Tribunal. The Tribunal had no involvement in the dispute between HMRC and the appellants while HMRC's enquiries were ongoing or when HMRC issued their closure notice. Therefore, on any normal reading of Rule 8(3)(b), however HMRC conducted their enquiry or behaved when issuing the closure notices, there was no failure to co-operate with the Tribunal. It follows that, applying a normal reading of Rule 8(3)(b), I have no power to bar HMRC as the necessary pre-condition was not met.

29. Ms Murray put the overriding objective set out in Rule 2 of the Tribunal Rules at the heart of her submissions. Rule 2 provides as follows:

> **2 Overriding objective and parties' obligation to co-operate with the Tribunal**
>
> (1) The overriding objective of these Rules is to enable the Tribunal to deal with cases fairly and justly.
>
> (2) Dealing with a case fairly and justly includes--
>
> (a) dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties;

[1] Rule 8(7) extends this principle to applications to bar HMRC from participating in proceedings

(b) avoiding unnecessary formality and seeking flexibility in the proceedings;

(c) ensuring, so far as practicable, that the parties are able to participate fully in the proceedings;

(d) using any special expertise of the Tribunal effectively; and

(e) avoiding delay, so far as compatible with proper consideration of the issues.

(3) The Tribunal must seek to give effect to the overriding objective when it--

(a) exercises any power under these Rules; or

(b) interprets any rule or practice direction.

(4) Parties must--

(a) help the Tribunal to further the overriding objective; and

(b) co-operate with the Tribunal generally.

30. I agree with Ms Murray that the Tribunal should always consider the overriding objective set out in Rule 2 of the Tribunal Rules when deciding whether to exercise its powers under those rules. I also accept that, on occasions, the overriding objective in Rule 2 might shed a light on what particular provisions of the Tribunal Rules are intended to mean. For example, as Ms Murray correctly submitted, in *Hills v HMRC* [2016] UKUT 266 (TC), the Upper Tribunal interpreted an appellant's right to opt out of the costs-shifting regime in Rule 10(1)(c)(ii) of the Tribunal Rules by presuming that this provision was not intended to give rise to injustice. However, the appellants' argument goes far beyond any reasonable purposive interpretation of Rule 8(3)(b) and amounts to an assertion that general considerations of fairness should permit the Tribunal to bar HMRC from proceedings even though the basic pre-condition of Rule 8(3)(b) is not met.

31. I do not, therefore, have power to bar HMRC as Rule 8(3)(b) is not engaged. The appellants' application is dismissed for that reason alone. I do not, therefore, need to consider any questions of the scope of the Tribunal's jurisdiction as conferred by s50(6) of TMA 1970. I will, say, however, that if it were necessary for me to express a conclusion (which it is not), I would find that there was no legitimate expectation on the part of the appellants that HMRC's enquiries were limited in any way. As I have found, Mr Colman had a genuine belief that HMRC's objections to the loss that the Partnership had claimed were limited to concerns about the valuation of the relevant films. However, I am not satisfied that the belief was reasonable or enough to give rise to a "legitimate expectation": it was a genuine, but mistaken, belief and nothing more.

**The disclosure application**

32. The appellants' original application for disclosure made in May 2016 requested disclosure in the following terms:

The Appellants seek disclosure from HMRC of all relevant documents (in other words Standard CPR disclosure) in whatever form, and in

particular those which support the Appellants' case and/or which adversely affect HMRC's case in accordance with CPR rule 31.6.

33. The Appellants' renewed application of 1 June 2017 does not suggest that they are seeking a narrower category of documents and I have therefore taken them as repeating their original application.

34. The parties were agreed that the Tribunal has power to direct that HMRC disclose documents. I will therefore consider the question of whether to exercise that power in the light of all relevant factors, including the overriding objective set out in the Tribunal Rules.

35. If I grant the appellants' application for disclosure, it is possible that the appellants will obtain documents relevant to their appeals that they do not currently have. That could certainly help the Tribunal to deal with their appeals fairly and justly.

36. However, desirable though it is that the appellants should be able to have access to all relevant documents, that is not the only factor relevant to the evaluation of the overriding objective. The Tribunal must exercise its case management powers proportionately and must also seek to avoid delay where practicable.

37. The appellants' application as drafted is manifestly disproportionate. They have made no attempt, in advance of the hearing, and having seen HMRC's objections, to refine it to require specific documents or classes of documents that HMRC are likely to have. If I allowed the application, HMRC would have to search through 17 terabytes of data and ask whether each individual document might support the appellants' case or adversely affect HMRC's case. That would be a vast exercise. Moreover, the application makes no allowance for the steps that HMRC have taken to date. As I have found, HMRC have already performed a search of documents that they have electronically stored using keywords that the appellants themselves provided. Ms Murray, in her submissions, seemed to be under the impression that HMRC's search had not extended to the hard copy documents that HMRC seized that were stored in the "50 bankers' boxes". However, Officer Condie's evidence, which was not challenged, made it clear that HMRC had searched <u>all</u> documents that were stored electronically (including those in the 50 bankers' boxes that had been scanned in).

38. I acknowledge that HMRC's searches are unlikely to have unearthed all relevant documents. I can also understand why Mr Colman was concerned when HMRC's disclosure exercise did not provide the appellants with documents that he had obtained from other sources. However, that is not a good reason for requiring HMRC to start their searches all over again. First, as I have found, HMRC did not necessarily seize all relevant documents in the first place and Officer Condie noted that they had never obtained certain documents that were stored on storage devices in France and Monaco. It would clearly be disproportionate to require HMRC to search 17 terabytes of data based on Mr Colman's suspicion that HMRC did not disclose relevant documents when it is not even clear that HMRC have the documents that Mr Colman thought should have been disclosed. Second, to the extent that HMRC's searches failed to locate relevant documents because the search terms that the appellants were provided were

inadequate, it would clearly be disproportionate to require HMRC to bear the consequences of that.

39. In addition, considerations of delay are relevant. The appellants' application for disclosure was made in May 2016 and compromised in November 2016. The appeals already relate to matters that took place several years ago. It is undesirable that the hearing of these appeals should be delayed any further by requiring HMRC to undertake a disclosure exercise which has already been settled by agreement. If the appellants regret their settlement of the May 2016 application, or regret their choice of search terms, that is a matter for them. It should not result in the hearing of these appeals being delayed still further.

**Conclusion and application for permission to appeal**

40. Both of the appellants' applications are refused.

41. 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.

**JONATHAN RICHARDS**

**TRIBUNAL JUDGE**
**RELEASE DATE: 16 MARCH 2018**