TC05544

Appeal number: TC/2015/04587
TC/2015/06420

CAPITAL GAINS TAX – asset purchased with, and sold for, Swiss Francs – computation of gain – rule in Bentley v Pike and Capcount Trading followed – Liechtenstein disclosure facility – amount of penalty chargeable

FIRST-TIER TRIBUNAL
TAX CHAMBER

GEORGE KNIGHT **Appellant**
INGEBORG KNIGHT

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at Fox Court, Brooke Street, London on 6 December 2016

Danny Knight for the Appellants

Marie McGregor, Officer of HM Revenue & Customs, for the Respondents

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DECISION

1. The appellants are appealing against discovery assessments to capital gains tax ("CGT") that HMRC made in consequence of the appellants' disposal of a property in Switzerland and associated penalties. The appellants purchased the property in 1988 for a price in Swiss Francs. They disposed of the property in January 2010 and received a consideration in Swiss Francs and also incurred expenses connected with the property which they paid in Swiss Francs. The matters in dispute, and in respect of which the Tribunal has jurisdiction, can be summarised as follows:

(1) The appellants argue that the correct way to calculate the chargeable gain on disposal is firstly to calculate the gain that they made in Swiss Francs by subtracting the aggregate of the expenditure that they incurred in respect of the property (in Swiss Francs) from the Swiss Franc disposal proceeds. That produces a gain in Swiss Francs which should then be converted into sterling at the exchange rate applicable on the date of disposal for the purposes of calculating their CGT liability. That method of calculation was referred to, at the hearing, as "Method A".

(2) HMRC argue that Method A is incorrect and they adopted a different method ("Method B") when making the assessments. Under Method B, each item of expenditure that the appellants incurred in respect of the property (including the cost of acquisition) was converted into sterling at the exchange rate applicable on the date that expenditure was incurred. The sum of those sterling amounts represented the appellants' total allowable expenditure in respect of the property. HMRC then determined the sterling equivalent of the sale proceeds that the appellants received by converting the Swiss Franc disposal proceeds into sterling at the exchange rate applicable on the date of disposal. The difference between the sterling equivalent of the sale proceeds and the sterling amount of total allowable expenditure represented the gain arising on disposal and HMRC used this figure to calculate the appellants' respective CGT liabilities.

(3) The appellants did not include within their tax returns for the 2009-10 tax year any amount in respect of the gain they made on the property. Nor did they make any mention on their tax returns from 1988 to 2010 of rental income that they received on the property. Mr Knight accepted that their failure to do so was deliberate. The appellants availed themselves of the "Liechtenstein Disclosure Facility" ("LDF"). HMRC argue that the appellants are liable to penalty equal to 20% of the "potential lost revenue". The appellants argue that, in accordance with the LDF, the penalty should be limited to 10% of potential lost revenue.

2. HMRC's Fraud Investigation Service have pursued enquiries into the appellants' tax affairs under HMRC's Code of Practice 8. The appellants consider that this was not the approach HMRC should have taken as the dispute between HMRC and the appellants was essentially one of law (namely whether the chargeable gain should be calculated using Method A or Method B). Mr Knight asked me to issue a declaration to this effect. I explained at the hearing, however, that the Tribunal has no

jurisdiction to consider complaints such as this. If the appellants are unhappy with HMRC's conduct, their remedy is to complain to HMRC and, if not satisfied, to pursue the matter to the Adjudicator's office. Alternatively, they may consider bringing proceedings for judicial review in the courts. However, the Tribunal is a creature of statute: it has no public law function and its jurisdiction is limited to matters prescribed by statute (which do not include the matters relating to Code of Practice 8 to which Mr Knight referred). In those circumstances, I indicated to the parties at the hearing that I would not hear any argument relating to the Code of Practice 8 issue.

3. The parties explained at the hearing that they were agreed as to the relevant figures that should be used in order to calculate the appellants' CGT liability and penalty. Therefore, they did not require the Tribunal to make findings as to quantum. All they sought from the Tribunal (given that I concluded that there was no jurisdiction to deal with the Code of Practice 8 issue) was a decision in principle as to whether Method A or Method B should be followed and whether the applicable penalty percentage was 10% or 20%.

Evidence

4. The parties were agreed on most, if not all, of the relevant facts and neither party relied on witness evidence.

5. HMRC prepared a bundle of relevant documents and I was referred to a few of these documents during the hearing.

Facts

6. The facts set out below were either agreed by the parties or were determined by me.

Facts relevant to the assessments and penalties

7. The appellants acquired a property in Switzerland (the "Property") on or around 15 August 1988. They paid a consideration in Swiss Francs to acquire the Property. They incurred expenses associated with the acquisition (such as legal costs and agents' costs) and expenses in developing the property all of which were charged for, and paid in, Swiss Francs.

8. The appellants disposed of the Property on or around 15 January 2010 for a consideration that was charged, and paid, in Swiss Francs.

9. The appellants submitted their self-assessment tax returns for the tax year 2009-10 on or around 21 October 2010. Neither appellant's tax return made any mention of the gain that had been made on disposal of the Property. Both appellants admit that they acted deliberately in this regard.

10. On 2 April 2013, the appellants made disclosures to HMRC, in accordance with the LDF, of amounts of income tax and capital gains tax that was due in connection with the Property. Insofar as relevant to this appeal, the parties agreed that the appellants have co-operated fully and have complied with all requirements imposed by the LDF.

11. On 28 May 2013, HMRC commenced enquiries under Code of Practice 8.

12. On 8 January 2015, HMRC issued both appellants with discovery assessments under s29 of the Taxes Management Act 1970 ("TMA 1970") for the 2009-10 tax year relating, inter alia, to their respective chargeable gains on disposal of the Property. Mr Knight admitted that those discovery assessments were validly made although, since the assessments were made by applying Method B rather than Method A, the appellants dispute the amount of the assessments. Mr Knight also admitted that, although the assessments were issued more than four years after 5 April 2010 (the end of the 2009-10 tax year), HMRC were entitled to rely on the extended time limit set out in s36 of the Taxes Management Act 1970.

13. HMRC also notified the appellants of penalties that were due on or around 7 January 2015.

14. On 24 February 2015, the appellants appealed to HMRC against the assessments and penalties on the grounds, among others, that Method A should be used and the applicable penalty rate was 10% rather than 20%. HMRC had previously agreed to extend the deadline for the appellants to appeal until 27 February 2015 and these appeals were, accordingly, in time.

15. On 15 May 2015, HMRC issued amended penalty assessments to both appellants.

16. On 30 June 2015, following an internal HMRC review, HMRC upheld their decision to apply Method B for the purposes of the assessments and to apply a penalty percentage of 20%, rather than 10%.

17. On 3 August 2015, the Tribunal received notification of the appellants' appeals. There appears to have been some suggestion that either or both appeals might have been late (by a matter of a couple of days at most). I will not make any determination of whether the appeals were late since Mrs McGregor confirmed that HMRC were not raising any objection to the appeals being considered on the grounds that they were made late. Therefore, I will simply say that, to the extent the appeals were made late, I will grant the appellants the necessary extension of time.

The Liechtenstein Disclosure Facility

18. The LDF was constituted by means of a Memorandum of Understanding dated 11 August 2009 (the "MOU") between the Government of the Principality of Liechtenstein and Her Majesty's Revenue & Customs of the United Kingdom. The Preamble to the MOU records that the Government of Liechtenstein would introduce

a "five-year taxpayer assistance and compliance programme" under which financial institutions in Liechtenstein would have a duty to identify clients who might have a UK tax liability and, unless satisfied that these clients either had no UK tax liability, or that they had discharged any such liability, to cease to act for them or take other approved action. In return, HMRC would provide a "special disclosure facility" under which taxpayers notifying HMRC of tax liabilities would obtain certain favourable terms.

19. Schedule 7 of the MOU set out the detailed terms of the "special disclosure facility" that HMRC would offer. Paragraph 5(b) of Schedule 7 provided that an eligible person who complied fully with applicable obligations under the disclosure facility would be charged a fixed penalty of 10% of the tax payable.

20. In July 2010, HMRC published guidance on the LDF. That guidance confirmed that, for liabilities within the LDF, applicable penalties would be fixed at "10% of the tax payable".

21. On 11 November 2010, HMRC and the Government of Liechtenstein issued a "Second Joint Declaration". Section 7 of the Second Joint Declaration stated, so far as material, as follows:

> a. The parties wish to clarify that where none of the exceptions under the LDF apply, a penalty of 10% on the unpaid UK tax will be chargeable for tax years up to 5 April 2009…
>
> b. For subsequent years the penalty will be based on the appropriate level due under UK legislation for the respective behaviours (such as reasonable care, careless, deliberate, or deliberate and concealed). Provided the relevant person co-operates fully and makes a full and complete disclosure, the minimum level of penalty will be applied.

22. The hearing bundle contained some Frequently Asked Questions that HMRC published in relation to the LDF. I had no evidence, however, as to when these were published although, since those Frequently Asked Questions referred to matters that occurred on 24 July 2013, it is clear that they were published on or after that date.

Paragraph 6.1 of that document set out an answer to the question:

> In respect of disclosures for the tax years ended up to 5 April 2009, what exceptions are there to the fixed 10% penalty?

Paragraph 6.3 included the following section:

> **I have previously submitted incorrect tax returns to HMRC and as I qualify for the full terms of the LDF will have to pay a penalty of 10% for the years to April 2009. What will the level of penalty be for the 2 years 2009 to 2010 and 2010 to 2011?**
>
> For the 2009 to 2010 and 2010 to 2011 tax years the penalty due under the LDF will be based on the appropriate level due under UK legislation for the respective behaviours. Provided you co-operate fully

and make a complete disclosure under the terms of the LDF, the minimum penalty will be applied as follows:

- No penalty where reasonable care is agreed or unprompted disclosure of careless behaviour has been claimed and accepted by HMRC
- 20% for unprompted disclosure of deliberate behaviour

23. In 2015, HMRC updated their guidance on the LDF. That guidance included the following section:

Penalties

LDF Liabilities

In relation to LDF liabilities, the penalty will be fixed at 10% of the tax payable.

Other Liabilities

See Page 3 and 4 'Do I qualify to use the LDF?' for circumstances under which you will not qualify to use favourable terms. In those circumstances and for all years after 5 April 2009 penalties are chargeable in accordance with the legislation in place at the time.

Relevant statutory provisions

24. Section 1 of The Taxation of Chargeable Gains Act 1992 ("TCGA 1992") imposes a charge to tax on "chargeable gains". Other provisions of TCGA 1992 set out in detail how chargeable gains are to be calculated.

25. Section 38 of TCGA 1992 sets out a list of sums that are allowable as a deduction in computing chargeable gains including:

(a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset…

26. Section 21(1) of TCGA 1992 provides as follows:

21 Assets and disposals

(1) All forms of property shall be assets for the purposes of this Act, whether situated in the United Kingdom or not, including -

…

(b) currency, with the exception (subject to express provision to the contrary) of sterling.

27. The penalties that have been assessed were imposed pursuant to Schedule 24 of the Finance Act 2007 ("Schedule 24"). Since there was no dispute that a penalty was properly chargeable, and the only question was the penalty percentage that should apply, I will not quote the statutory provisions in detail, but will refer only to those that are relevant to my conclusion on the penalty issue.

28. Paragraph 1 of Schedule 24 sets out the circumstances in which a penalty is payable. There was no dispute that these circumstances were met: the appellants had delivered tax returns to HMRC (which were documents specified in paragraph 1 of Schedule 24), those tax returns contained inaccuracies (in that they failed to include, inter alia, the chargeable gain accruing on disposal of the Property) and those inaccuracies were deliberate on the appellants' part (see [9] above).

29. Paragraph 4 of Schedule 24 sets out the "standard amount" of penalty that is payable. HMRC have determined inaccuracy behaviour as being "deliberate but not concealed" action falling within "category 1" with the result that the standard amount is 70% of "potential lost revenue". The appellants accept that characterisation of the inaccuracy (although they argue that it is not relevant to the amount of penalty that should be charged since the LDF in force at the relevant time prescribed a penalty percentage of 10%).

30. Paragraph 5 of Schedule 24 defines the "potential lost revenue" (being the amount to which the penalty percentage is applied in order to determine the actual penalty payable). In the circumstances of this appeal, the "potential lost revenue" is the amount of CGT for which the appellants are liable in respect of their disposal of the Property.

31. Paragraphs 9 and 10 of Schedule 24 permit HMRC to reduce penalties below the standard amount chargeable pursuant to paragraph 4 of Schedule 24. The parties were agreed that the disclosure was "unprompted" and, in those circumstances, the minimum penalty chargeable would be 20% of potential lost revenue.

32. Paragraph 11 of Schedule 24 permits HMRC to reduce a penalty due under paragraph 1, including to an amount below the minimum stipulated in paragraph 10, if there are "special circumstances".

33. Paragraph 15 of Schedule 24 confers rights of appeal. A taxpayer has the right to appeal against, inter alia, a decision of HMRC that a penalty is chargeable and a decision as to the amount of the penalty.

34. Paragraph 17 of Schedule 24 sets out the Tribunal's powers on an appeal which includes a power to substitute for HMRC's decision another decision that HMRC had power to make. However, this power is qualified in some respects. In particular, if the Tribunal substitutes its decision for that of HMRC, it may rely upon paragraph 11 of Schedule 24 (relating to "special circumstances") to a different extent from HMRC only if the Tribunal thinks that HMRC's decision on the application of paragraph 11 was flawed. Paragraph 17(6) provides that a decision is "flawed" if it is flawed when considered in the light of principles applicable in proceedings for judicial review.

Discussion – whether to apply Method A or Method B

35. This question has come before the courts on two occasions previously: before the Court of Appeal in *Capcount Trading v Evans (HM Inspector of Taxes)* [1993] STC 11 and before the High Court in *Bentley v Pike (Inspector of Taxes)* [1981] STC

360. Both authorities are binding on me and both reached the clear conclusion that Method B is correct. I will focus my analysis on *Capcount Trading* since that is the decision of the superior court and, moreover, the authority in which the issue was considered in the greater detail.

5 36. The *ratio* (or principle) of the Court of Appeal's decision in *Capcount* was that, since foreign currency (as distinct from sterling) was a distinct asset for CGT purposes (under what is now s21(1)(b) of the Taxation of Chargeable Gains Act 1992), expenditure incurred in a foreign currency is expenditure that consists of giving up a distinct asset, and not expenditure in "money". Similarly, receipts of 10 foreign currency are receipts of separate assets for CGT purposes. Since sterling is the proper unit of account for CGT purposes, expenditure that is incurred by giving up foreign currency needs to be valued by converting the foreign currency into sterling at the exchange rate prevailing on the date of expenditure. Similarly, receipts in a foreign currency need to be converted into sterling at the rate prevailing on the date of 15 receipt. That emerges clearly from Nolan LJ's judgment (on page 24 of the reported decision) and from Staughton LJ's judgment (on page 28 of the reported decision). Mann LJ agreed with the conclusions of both Nolan LJ and Staughton LJ.

37. Mr Knight argued that *Capcount* could be distinguished as relating only to situations in which numerous currencies were involved, leaving open the possibility 20 for Method A to apply in situations where expenditure was incurred (and consideration received) in the same foreign currency. That argument is simply not compatible with the actual decision in *Capcount*. I consider the Court of Appeal's decision to be absolutely clear, but even if there were room for doubt, Nolan LJ states in terms that his reasoning applies to a situation involving a purchase and a sale in the 25 same currency in the following passage of his judgment:

> Therefore when the taxpayer company acquired the Canadian shares for Canadian dollars it gave a consideration in money's worth which fell to be valued in sterling terms for the purposes of computing both the gain (if any) on the disposal of the dollars and the cost of 30 acquisition of the shares. By the same token, when the shares were sold for Canadian dollars the consideration for United Kingdom tax purposes was not money, but another asset whose value fell to be translated into sterling terms for the purpose of computing the gain or loss on the disposal of the shares.
>
> 35 Putting the matter more broadly, I accept the Crown's proposition that, for better or worse, the capital gains tax which forms the basis of the corporation tax on chargeable gains is a tax measured on differences computed in pounds sterling and in no other way.

38. Mr Knight referred to passages of Nolan LJ's judgment in which he recorded 40 points that counsel for the appellants accepted during the course of making his submissions. For example:

> Thus, as Mr Park frankly accepted, the taxpayer company's approach of computing the gain or loss in a foreign currency and then translating it into sterling could not on any view of the matter be adopted unless 45 both the purchase price and the sale price were paid in the same

> currency. In applying para 4(1)(a) to a particular acquisition and disposal one cannot, so to speak, subtract peas from beans. He accepted, in other words, that unless the currency for which the acquisition was made was the same as the currency for which the disposal was made one had to fall back on sterling as what he called the residual currency, and adopt the approach for which the Crown contends.

39. However, that is a passage dealing with points that counsel accepted when making his submissions. They do not, as a matter of either logic or language, mean that Nolan LJ is expressing a conclusion that a different result should apply in cases where the purchase price and disposal proceeds are denominated in the same foreign currency. Indeed, it is clear that Nolan LJ refers to counsel's admissions to explain that he could not accept his submission that Method A should be adopted as Method A could not be of universal application (as it would not apply where purchase consideration and sale proceeds were in different currencies) whereas Method B was capable of universal application. A similar point can be made in relation to a similar passage in Staughton LJ's judgment.

40. Mr Knight relied on statements of the House of Lords in *Aberdeen Construction Group Ltd v IRC* [1978] AC 885 to the effect that CGT is a tax on gains and not on arithmetical differences and in *W.T. Ramsay Ltd v IRC* [1981] All ER 685 to the effect that CGT must operate in the "real world and not that of make believe". However, those are general statements as to the approach a court should take to the construction of statutory provisions relevant to CGT. They cannot undo the clear effect of the Court of Appeal's decision.

41. Mr Knight submitted that it was contrary to the Bill of Rights for HMRC to apply Method B since it is not expressly provided for by statute. There is nothing in that argument. The statute clearly authorises the Crown to levy a tax on capital gains. The courts then need to construe that statute to determine how the gain is to be computed. There is no sense in which that contravenes the Bill of Rights.

42. Other points that Mr Knight raised can be dealt with briefly:

(1) HMRC may well have a power pursuant to s5 of the Commissioners for Revenue and Customs Act 2005 to exercise discretion in cases involving manifestly unfair results. However, applying Method B to the calculation of the chargeable gain, when that is the approach that the courts have determined to be correct, is not a manifestly unfair result. Even if it were, the Tribunal has no jurisdiction to interfere with HMRC's decision not to exercise a discretion for reasons I have already given.

(2) Mr Knight argued that *Bentley v Pike* was not binding authority as it was confined to matters involving an inheritance. I do not agree. *Bentley v Pike* clearly sets out the principle underpinning the calculation of a chargeable gain. Moreover, the principle enunciated in *Bentley v Pike* was approved by the Court of Appeal in *Capcount*.

(3) It is not relevant that *Capcount* made reference to s30(1) of Finance Act 1965 dealing with CGT on disposal of chattels. The decision in *Capcount* is not limited to situations involving a disposal of chattels. It outlines a general principle.

5 43. In deference to the amount of time and effort that the appellants and Mr Knight have clearly spent over the years in seeking to establish that Method A is correct, I have set out my reasoning in fuller detail than I might otherwise have done. In reaching my conclusion, I am not necessarily endorsing the part of the reasoning that HMRC adopted in their letter of 30 June 2015 (setting out their conclusions following 10 their internal review) relating to the appellants' "functional currency". It seems to me that the concept of a "functional currency" does not apply to CGT (although it does apply to the charge to corporation tax on income). It may be that the reference to a "functional currency" was a shorthand way of noting that sterling is the proper unit of account for CGT purposes (which would be entirely in accordance with the decisions 15 in *Capcount* and *Bentley v Pike*). However, in order to determine this appeal, I do not need to decide what HMRC meant by their reference to "functional currency" since they are clearly right to apply Method B. It is quite simply not arguable that Method A can be defended given the authorities of *Capcount* and *Bentley v Pike*.

Discussion - the amount of penalty due

20 44. HMRC have applied the minimum percentage penalty (20%) that can be applied in accordance with Schedule 24 for deliberate inaccuracies (unless there are "special circumstances"). However, the appellants argue that, under the terms of the LDF, the applicable percentage is 10%. The essence of Mr Knight's argument was that, at the time the appellants disposed of the Property, the form of the LDF "in force" was as 25 set out in the MOU. As noted at [19] the MOU provided for a penalty percentage of 10%. Mr Knight accepted that the Second Joint Declaration signed on 11 November 2010 set out a different position but submitted that it was not relevant to the determination of the penalties since the appellants disposed of the Property before the Second Joint Declaration was made.

30 45. I believe that there is a fundamental flaw with this argument. Mr Knight was approaching the LDF as if it were a statutory provision. However, the LDF does not form part of the primary or secondary legislation of the United Kingdom. On the contrary, it is set out partly in agreements between HMRC and the Government of Liechtenstein (to which the appellants are not party) and partly in public (non-35 statutory) statements that HMRC have made to taxpayers. I do not consider that the Tribunal has any jurisdiction to consider complaints that HMRC have not honoured their agreement with the Government of Liechtenstein. Nor do I consider that the Tribunal has jurisdiction to consider arguments to the effect that, whatever the position set out in Schedule 24, HMRC should still have applied a lower level of 40 penalty given the public statements they made on the LDF. It seems to me that such arguments are based on public law and, since the Tribunal has no judicial review function, would have to be pursued in the courts.

46. It follows that I have not accepted Mr Knight's arguments based on the terms of the LDF "in force" at various times. Even if I did have power to require HMRC to adhere to the terms set out in the LDF, I would not have accepted Mr Knight's arguments as I believe HMRC have applied the LDF correctly. The LDF cannot, properly understood, be seeking to link the amount of penalty chargeable to the version of the LDF "in force" at the time the Property was disposed of. Indeed, at the time the Property was sold, the appellants presumably had no intention of telling HMRC of the resulting CGT liability whether under the LDF or otherwise (as demonstrated by their deliberate failure, a few months after the disposal, to include the gain on their UK tax return). The LDF was simply not relevant to the appellants at the time of disposal. It is entirely logical, therefore, that if HMRC decide to operate the LDF, they should base the penalty chargeable on the terms of the LDF as applicable at the time a taxpayer makes a disclosure. The appellants made their disclosure in 2013 by which time the Second Joint Declaration had been made which made it absolutely clear that the penalty applicable in the 2009-10 tax year would be the minimum penalty chargeable under Schedule 24.

47. Although Mr Knight did not put his case in this way, I have considered whether it could be said that HMRC's perceived failure to apply the LDF correctly amounted to a "special circumstance" which could justify reducing the penalty below the minimum level of 20%. However, the Tribunal's jurisdiction on "special circumstances" is limited. As noted at [34], I could only interfere with HMRC's conclusion if I considered that their approach to the question of "special circumstances" was flawed when considered in the light of principles applicable to judicial review. I do not consider it was. HMRC turned their mind to the LDF and applied it in a manner that was reasonable (indeed in a manner which I consider to be consistent with the terms of the LDF). In doing so, they made no error of law. It follows, therefore, that I do not have the power to reduce the penalty below 20%.

Conclusion

48. For the reasons set out above, my decision on the points of principle that the parties asked me to resolve is as follows:

(1) The gain arising on disposal of the Property should be calculated using Method B (as HMRC argue).

(2) The applicable penalty percentage is 20% (as HMRC argue).

49. The parties indicated that they could agree the amount of the appellants' tax liabilities and the penalties payable based on this decision in principle. Within 28 days of release of this decision, they must both write to the Tribunal to confirm whether they have agreed these matters.

50. This document contains full findings of fact and reasons for the decision in principle. 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.

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JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 13 DECEMBER 2016