IN THE HIGH COURT OF JUSTICE **Claim No. CO/12618/2011**
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT
London

B E T W E E N:

THE QUEEN on the application of

UK UNCUT LEGAL ACTION LIMITED

Claimant

-and-

THE COMMISSIONERS OF HER MAJESTY'S REVENUE AND CUSTOMS

Defendant

-and-

(1) GOLDMAN SACHS INTERNATIONAL
(2) GOLDMAN SACHS SERVICES LIMITED

Interested Parties

CLAIMANT'S SKELETON ARGUMENT

For hearing: Thursday 2 May 2013, 1 day

Suggested reading: Litigation and Settlement Strategy [250], Meeting minutes [257], Witness statement of David Hartnett, Exhibits DH1 and DH3 [D22, 50], National Audit Office Report [506]

A. Introduction

1. On 19 November 2010, the Permanent Secretary to HMRC (Mr David Hartnett CB) 'shook hands' [257] on a settlement with the Interested Parties (together "Goldman Sachs"). The settlement was reached:

    a) in breach of HMRC's statutory duties;

    b) in breach of its Litigation and Settlement Strategy;

c) taking into account irrelevant considerations; and

d) without any element of interest for national insurance contributions outstanding for over 5 years.

2. The settlement arose out of a tax avoidance scheme designed to avoid payment of national insurance contributions on bonuses. HMRC had warned Goldman Sachs in 2005 that if it continued resisting payment, it would be charged interest. But in the event, after enjoying over 5 years additional use of the funds, no interest was charged.

3. The error was identified quickly by HMRC's internal review procedures. HMRC's High Risk Corporate Programme Board rejected the proposed settlement. Nevertheless, and despite legal advice that the agreement was not binding, Mr Hartnett and another Commissioner elected to affirm the settlement and not re-open it. This decision was influenced and affected by Mr Hartnett's concern to avoid personal embarrassment, the risk of embarrassment to HMRC and other ministers and officials.

4. The exact amount of money lost as a result of the failure to claim interest is not known. HMRC has admitted that the failure to agree any interest component as part of the settlement has led to a loss to the national insurance fund of at least £5-8 million.[1] However, the Public Accounts Committee has received evidence that the true figure may be up to £20 million.[2]

5. The effect of the decision was to reward Goldman Sachs for several years of failing to pay. As Viscount Simon LC put it in *Latilla v IRC* [1943] AC 377 at 381 discussing tax avoidance schemes:

[1] Evidence of Amyas Morse to Public Accounts Committee, Q121 [295] The NAO Report states that the disputed interest was "slightly lower" than other disputed sums which were "in the tens of millions": NAO Report, Appendix One, Paragraph 69 [549].
[2] Public Accounts Committee Report, Conclusion and Recommendation 5 [487].

> "…one result of such methods, if they succeed, is ... to increase, *pro tanto*, the load of tax on the shoulders of the great body of good citizens…"

6. HMRC's decision was unlawful, on ordinary principles of public law:

   a) The settlement violates the principle identified by Lord Scarman in *Fleet Street Casuals* [1982] AC 617 at 651:

   > "… the modern case law recognises a legal duty owed by the revenue to the general body of the taxpayers to treat taxpayers fairly; to use their discretionary powers so that, subject to the requirements of good management, discrimination between one group of taxpayers and another does not arise; to ensure that there are <u>no favourites and no sacrificial victims</u>. The duty has to be considered as one of several arising within the complex comprised in the care and management of a tax, every part of which it is their duty, if they can, to collect" (emphasis added).

   b) The settlement breaches HMRC's published Litigation and Settlement Strategy.

   c) The settlement was reached taking into account irrelevant and extraneous considerations, including the personal reputations of the officials responsible for the error, and potential embarrassment to officials, the Chancellor of the Exchequer and HMRC. None of these matters are relevant to the proper care and management functions of HMRC.

7. The Court is invited to make declarations that HMRC:

   a) acted contrary to its statutory duties;

   b) failed to comply with its Litigation and Settlement Strategy; and

   c) took into account irrelevant considerations in concluding and approving the settlement with Goldman Sachs.

8. The Claimant does not seek an order quashing the settlement itself. Simon J refused permission to seek a quashing order because of the potential effect on the Interested Parties (see [2012] EWHC 2017 (Admin) at [14]). However, HMRC continues to assert that that it acted lawfully and that it would be entitled to act in a similar way in the future. This claim is brought to correct that misapprehension.

B. The Parties

9. The Claimant is a campaigning group. It campaigns against the harmful effects of tax avoidance and the use of tax havens. It supports the protection of health, education and social welfare services funded by taxation. It brings this case with the assistance of a protective costs order limiting its liability to £20,000 (which has been fundraised from the public, the vast majority from numerous individual donors offering small sums).

10. The First Interested Party is a well-known investment bank. The Second Interested Party is a service company that employed the bank's London staff. Goldman Sachs has been served, but has decided not to play any active part in this claim.

C. Legal framework

11. The Commissioners for Revenue and Customs Act 2005 sets out the function and duties of the Commissioners of HMRC. The Commissioners are responsible for "the collection and management of revenue" (section 5(1)). Revenue "includes taxes, duties and national insurance contributions" (section 5(4) [1000-1004].

12. Section 5(1) gives the Commissioners a wide managerial discretion as to the best means of obtaining the highest net return to the exchequer, having regard to the staff available and the cost of collection (see *Fleet Street Casuals* [1982] AC 617 at 636 per Lord Diplock).

However, the discretion is not unbounded. "Discriminatory leniency" to a taxpayer or group of taxpayers would justify the intervention of the Court (p. 643 per Lord Diplock).

13. HMRC's policy on settlements is set out in its Litigation and Settlement Strategy (first published in 2007 and updated in 2011, after the events in this claim) [250]. The 2007 policy sets out "what represent[s] sufficient settlement terms". The aim of the policy is to ensure that HMRC adopts a fair and consistent approach to all taxpayers, taking into account HMRC's unique position:

> "14. General Principles.
>
> > * Deal with each dispute on its own merits. Do not enter into "package deals", in which a range of issues are settled for a single payment that is not subdivided amongst individual disputes.
> >
> > * Some disputes have an all-or-nothing character, involving a single point of law that would be decided one way or the other by the courts, with no middle ground **Such disputes should be settled on all-or-nothing terms**: do not split the difference or offer any discount for an agreement not to litigate. Similarly do not seek low value settlements in case where we are not prepared to litigate.
> >
> > …
> >
> > * Similarly, in a legal dispute if HMRC's arguments are not strong and/or the point at issue is not an important one, drop the case.
>
> 16. In **avoidance** cases
>
> …
>
> > * If our legal advice is strong, do not accept settlements for less than 100% of tax <u>and interest</u> due (bold emphasis in original, underlining added)."

14. In written evidence to the Public Accounts Committee, the Permanent Secretary for Tax explained the operation of the policy [353]:

> HMRC first published its Litigation and Settlement Strategy (the LSS) in 2007 and in July this year published an updated version. There has been no change in the principles underpinning the Strategy, however. <u>All disputes must be resolved in accordance with the law; HMRC does not "split the difference" with the taxpayer or enter into "package deals" in which one issue is traded off against another</u>.
>
> In many cases, HMRC believes there is one clear answer as to how tax law applies to an issue in dispute: in those cases, if the taxpayer is not willing to concede the point in full, HMRC will litigate the case. In other cases, because the application of tax law to a particular set of complex circumstances is not straightforward, there may be more than one possible answer as to how the issue in dispute should be resolved. The LSS recognises that possibility but makes clear that any resolution of the issue must be consistent with the law and represent an outcome that we would expect from litigation. Similarly, the LSS make clear that if, in the light of the facts of the case, HMRC does not have strong arguments on an issue in dispute, we should concede the point (underlining added).

15. The policy therefore provides as follows:

a) HMRC does not enter into package deals, in which one tax issue is traded off against another. Each issue must be settled on its own merits, separate from any other issues under consideration. Otherwise, taxpayers who raise numerous issues, or whose tax affairs are particularly complex, would enjoy an advantage over taxpayers where only a single issue is in dispute.

b) HMRC does not engage in "split the difference" negotiation. As such, a settlement negotiation with HMRC is unlike ordinary commercial bargaining, with discounts for litigation risk and suchlike. If HMRC thinks it has a good case, the taxpayer must pay in full, or HMRC will litigate. If HMRC thinks it has a bad case, its policy requires it to concede the point. This is an essential element of ensuring that there is consistency between taxpayers and ensuring that a tax imposed by Parliament is fairly collected.

c) Any settlement must represent a reasonable outcome that could be expected from litigation.

d) In tax avoidance cases, it is important to include not just tax, but also interest in the settlement. This is because the users of a scheme will hope to delay payment of tax, even if the scheme fails. The users of such scheme should not enjoy the windfall benefit of being able to retain tax for the period it takes to litigate about the effectiveness of the scheme.

e) The fundamental aim of the policy is to effect improvements in taxpayer behaviour. In particular, it is essential that taxpayers do not come under the impression that they can engage in ordinary commercial bargaining with HMRC, strategically playing off issues against each other.

C. Facts

16. In the late 1990s, Goldman Sachs began using a tax avoidance scheme. Many other banks also used the scheme. The scheme was intended to enable Goldman Sachs to avoid national insurance contributions on the bonuses paid to its London staff.

17. The scheme operated by granting options over shares in a company ("X"). When granted, the options were not valuable. However, X would then be fed with various payments that made its shares increase in value. The employees would in due course exercise the options. X would then offer to redeem the shares. Goldman Sachs contended that payments made using this device did not give rise to any liability to make national insurance contributions on the sums received by the employees.[3]

18. Properly analysed, this was not an effective means of avoiding national insurance contributions. All of the other users of this scheme settled with HMRC in 2005. Goldman Sachs was the only bank that did not settle with HMRC. When Goldman Sachs declined to settle, it was warned by HMRC that it would be required to pay interest in due course [306/Q255].

[3] See *Goldman Sachs International v HMRC* [2009] UKUT 290 (TCC)

19. In July 2010, the Upper Tribunal held that a very similar scheme for the avoidance of national insurance contributions was ineffective. See *HMRC v PA Holdings Limited* [2010] UKUT 251 (TCC).[4]

20. Later in July 2010, HMRC's leading counsel, Malcolm Gammie QC, gave "broadly positive" advice on HMRC's ability to recover all of the outstanding national insurance contributions from Goldman Sachs, plus interest.[5]

21. On 19 November 2010, Goldman Sachs and HMRC held a settlement meeting. At that meeting, HMRC was represented by a number of officials including Mr Hartnett. The meeting was held at Goldman Sachs' offices. Mr Hartnett attended "to deal with a very difficult relationship issue".[6]

22. At that meeting, a number of issues relating to Goldman Sachs' liability to tax were discussed. These included:[7]

    a) The question of Goldman Sachs' liability, and willingness, to pay the national insurance contributions in dispute.

    b) The interest accrued on the national insurance contributions.

    c) Goldman Sachs' tax treatment of an aspect of its employment arrangements.

    d) Three other "technical issues" relating to the specialised nature of Goldman Sachs' business.

[4] The taxpayer's appeal on the national insurance issue was dismissed by the Court of Appeal on 30 November 2011. See [2011] EWCA Civ 1414.
[5] Minutes of 8 December 2010 meeting [257-258]
[6] Evidence of Mr Hartnett to PAC, 12 October 2011, Q16 [287]
[7] NAO Report, Appendix One, Paragraph 68 [549].

23. By the end of the meeting, HMRC had agreed to settle these issues. HMRC agreed to discontinue its investigation of the employment arrangements issue, and conceded one of the three technical issues. Goldman Sachs conceded the remaining two technical issues.[8]

24. Goldman Sachs' head of tax also said he would "recommend" that Goldman Sachs sign up to the Code of Practice on Taxation for Banks "but this was in no sense part of a package" [D22].

25. Mr Hartnett's recollection of the negotiation was set out in an email dated 7 December 2010:

> "When we looked at the NICs issue I remembered that there had been a significant weakness in our technical position on interest. Mike [Housden, Head of European Tax for Goldman Sachs] acknowledged that and you recalled the issue but none of us could remember the detail. I recall (now) a major firm of accountants saying we had been very commercial with the settlement proposal but they had not spotted the weakness. <u>Steve suggested that we move on interest in return for them conceding 100% of NICs. That is what we ended up doing. I am looking for the 2005 legal advice</u>" [D22] (emphasis added).

26. Mr Hartnett reached an agreement whereby HMRC would "move on interest" in exchange for Goldman Sachs "conceding 100% of NICs" [D22]. Mr Hartnett appears to have made this significant concession because he (erroneously) recalled that there was a weakness in HMRC's position on interest. In fact, there was no such weakness. Mr Hartnett did not check the point before reaching an oral agreement with Goldman Sachs. Indeed, Goldman Sachs had expressly been told in 2005 that it would be required to pay interest if it delayed further.

27. There was real disquiet within HMRC at the proposed settlement. On 30 November 2010, the proposed settlement was placed before HMRC's High Risk Corporate Programme Board. It rejected the proposed settlement, given the failure to charge

[8] NAO Report, Appendix One, Paragraph 74 [550].

interest on the NICs. The Board's role is to take decisions for HMRC on certain large corporate tax settlements. The Board concluded that the interest should have been charged from the time that the other companies using the scheme settled because, in its view, otherwise Goldman Sachs would have benefited from its delay in settling this issue.[9] In particular, it would have had the use of the sums due by way of national insurance contributions for a further five years.

28. Goldman Sachs were informed of the Board's decision. It responded aggressively, "went off the deep end" and alleged "extreme bad faith" on the part of a named HMRC official [D22].

29. On 7 December 2010, Mr Hartnett set out his thoughts in an email. He proposed that the settlement be approved, even though the Board had rejected it:

> "My concern is not so much the decision of the HRCP programme board but rather the referral after GS had been made a without reservation offer. The technical issue on interest is yet to be resolved but if we were mistaken there is precedent for HMRC accepting an HRCP settlement offer which included "relief" for a mistake by a senior member of the Dept…
>
> <u>The risks here are major embarrassment to the [Chancellor of the Exchequer], HMRC, the [Large Business Service of the HMRC], you and me, not least if GS withdraw from the Code</u>" [D22] (emphasis added).

30. It is clear from this email that Mr Hartnett took into account the risk of "major embarrassment" to the Chancellor and to himself personally if the proposed settlement was not approved.

31. Mr Hartnett gives a bare denial in his witness statement ("I emphasise that my own personal reputation plated no part in our decision" [Hartnett para. 13 D17]) but he does not deal with this part of his email at [D22].

[9] NAO Report, Appendix One, Paragraph 77 [551].

32. On 8 December 2010, a meeting was held between HMRC's General Counsel, Mr Inglese, and other HMRC officials. The note of the meeting [257] records the discussion that took place. Officials remained extremely concerned about what had happened:

> "It was not clear whether [Mr Hartnett] had settled on £24m or on whatever the principal was. <u>There was discussion about whether there could be justification for settling without interest, especially in view of the Litigation Strategy. A particular problem was the 2005 ExCom settlements with all the other scheme users</u>. [Mr Inglese] asked if there was a risk of that being-reopened. DR/JS saying that whilst we would need to see the settlement paperwork, there would appear to have been a commercial deal, with consideration passing, so this seemed very unlikely to be a problem.
>
> <u>It was, however, clear that the proposed settlement gave GS no additional penalty for having resisted for 5 more years…</u>
>
> <u>[Mr Inglese] said that he would always want to assist [Mr Hartnett], but not if this were 'unconscionable'. He referred to the difficulty all those present at this meeting were having in justifying a settlement without an interest element"</u> (emphasis added).

33. Mr Inglese subsequently advised HMRC that the agreement reached on 19 November 2010 was not binding. As Mr Inglese put it in his evidence to the PAC "my advice… was that we could go back and reopen" (Q548) [331].

34. The following day, Mr Hartnett met with another Commissioner (Melanie Dawes) and the Chair of the Board (Freda Chaloner). Mr Hartnett and Ms Dawes decided to confirm the agreement with Goldman Sachs.[10] Ms Chaloner was present to assist only. No written record was made of this important meeting or of the reasons for the decision.[11]

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[10] NAO Report, Appendix One, Paragraph 90 [553], and HMRC's Summary Grounds of Resistance, Paragraph 28(c) [61].

[11] NAO Report, Paragraph 2.45 [533]

35. The next day (10 December 2010), Mr Hartnett telephoned his contact at Goldman Sachs to inform him that HMRC "would be going forward with the settlement" [Hartnett 13 D17].

36. On 22 February 2011, HMRC sent a written notice to Goldman Sachs confirming the oral settlement terms reached on 19 November 2010. The delay between the decision and the formal notification is unexplained in the evidence.

37. On 3 March 2011, Mr Hartnett sent a revised version of his email of 8 December 2010 to Ms Dawes, Ms Chaloner and another official. The note is in very similar form, but omits the references to major embarrassment to Ministers, Mr Hartnett and officials [D50]. No other emails, comments or drafts have been disclosed.

38. A lawyer at HMRC, Mr Osita Mba, was so troubled by the circumstances surrounding the settlement that he made disclosures under the Public Interest Disclosure Act 1998 to the National Audit Office and the Public Accounts Committee. Mr Mba provided written evidence to the PAC in March, May, October and November 2011. The PAC published Mr Mba's evidence on 8 December 2011.[12]

39. The Claimant sent a letter before claim on 18 October 2011 [750-757].

40. On 22 November 2011, *The Independent* reported "a senior judge is to be brought in to investigate…" [767].

41. On 14 December 2011, the Public Accounts Committee published its report into tax settlements reached by HMRC [480-503]. The report contained strong criticism of the conduct of HMRC [495-496]:

> 20. The importance of following established governance procedures is well illustrated by the case which resulted in a loss of interest. The C&AG told us this

[12] http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1531/1531we07.htm [389-479]

resulted in a loss of up to £8 million, although evidence we subsequently received from a whistle-blower suggests it could be as high as £20 million. The Department has admitted that its failure to charge interest on the liability was a mistake. It also admitted that the failure to fully apply its own governance procedures in this case was a further mistake. The case should have been referred to the Programme Board before settlement was agreed with the company, but this was only done after the settlement had been negotiated with the taxpayer. When the Programme Board did eventually consider the case, it rejected the settlement that had been reached because of the failure to claim interest and then referred the case to Commissioners for their consideration.

21. Having discovered the financial mistake, the Permanent Secretary for Tax sought advice from the General Counsel and Solicitor on the courses of action open to the Department. The advice received was that the Department had two options: it could revisit the settlement, or simply accept that a mistake had been made and not pursue the interest owed. The General Counsel and Solicitor told us that as part of his advice, he had expressed a personal preference for not reopening the settlement. The Permanent Secretary for Tax accepted this advice and did not reopen the settlement. As set out in the previous section of this Report, we were unable to secure answers to our questions as to why this course of action was followed, and we remain concerned that value for money was therefore not secured for the taxpayer.

22. This case highlighted significant shortcomings in the Department's procedures for reaching settlements of tax disputes. The team negotiating the case failed to consult the lawyers involved in litigating the case before they concluded the settlement. As the General Counsel and Solicitor himself acknowledged, it would be normal practice for the team negotiating a settlement to have consulted the litigating lawyers, and they should have done so in this case.

23. The Department did not produce a written note of the 19 November 2010 meeting with the company, despite the fact that this was the meeting where the settlement of the dispute was reached. Instead, the Department relied upon a note produced by the company itself. It is astonishing that the Department neglected to make its own record of such an important meeting. It is even more astonishing that the Permanent Secretary for Tax did not even know whether a note existed or not.

42. The PAC also expressed serious concerns about the reliability of the evidence it received from HMRC:

Conclusion & Recommendation 2 [486].

The evidence of the Department's senior officials fails to give us any confidence in the way large settlements are reached. The Permanent Secretary for Tax and the Department's General Counsel and Solicitor failed to answer our

> questions about specific cases in a spirit of openness. Some of the evidence they provided about the exact order of events, the extent of the Permanent Secretary for Tax's personal involvement in negotiations and whether legal advice was sought and acted upon was imprecise, inconsistent and potentially misleading. Furthermore, the Permanent Secretary for Tax was less than clear and consistent in the evidence he first gave to the Treasury Select Committee and then to the Public Accounts Committee.

43. As a result, "the Department has left itself open to suspicion that its relationships with large companies are too cosy". Further, "the Department is not being even handed in its treatment of taxpayers" (PAC Conclusions and Recommendations 7 and 8 [488]). The Committee welcomed the proposal of the NAO to carry out further work to consider the settlements.

44. The day after publication of the NAO report, Mr Hartnett met with the Comptroller & Auditor General, Mr Morse. He circulated a note of his meeting to his colleagues by email [503A]. The meeting was held to discuss the investigation being carried out by the NAO with the assistance of Sir Andrew Park. Mr Morse explained to Mr Hartnett that "<u>he [i.e. Morse] has made clear to the NAO that his expectation is that nothing of substance will be found in the review</u>" (emphasis added).

45. Mr Morse was influencing what ought to have been an independent inquiry, and giving a clear indication to his staff that he expected that nothing of substance should be found. Mr Hartnett was no doubt aware of the sensitivity of what he had been told by Mr Morse. He marked the email "<u>**PERSONAL & CONFIDENTIAL – PLEASE DO NOT PASS TO ANYONE WITHOUT COMING BACK TO ME**</u>" (emphasis in original) [503A].

46. Mr Morse's NAO report was published on 14 June 2012. His remit was to *"[examine] the reasonableness of five large tax settlements and* [HMRC's] *processes for reaching the settlements"*[13]. Sir Andrew Park provided tax advice to the NAO. However, his advice is

[13] NAO Report, page 5 [512].

not published in the NAO report, nor has it been disclosed. Rather, the NAO has sought to summarise parts of his advice. The settlement between HMRC and Goldman Sachs was one of the five settlements examined. Goldman Sachs is referred to as "Company E" throughout the NAO report.

47. This report concluded "*several things went wrong in the process by which the settlement was agreed*"[14]. These included:

a) The fact that HMRC did not seek legal advice before reaching a settlement with Goldman Sachs, despite the fact that there was ongoing litigation on this issue[15].

b) The fact that HMRC made a "governance error" in failing to realise that the proposed settlement had to be approved by the Board[16].

c) The fact that HMRC made no written record of the initial settlement meeting with Goldman Sachs, or of the later meeting at which two Commissioners decided to affirm the proposed settlement[17].

48. Despite these significant failings, the NAO report states that the "*overall settlement was reasonable*" when the settlement on national insurance is considered along with the other issues agreed between Goldman Sachs and HMRC. However, the NAO admitted that if the settlement on national insurance contributions and interest had been reached in isolation Sir Andrew Park "*would not have viewed the settlement as a reasonable one.*"[18] This was because there was no proper or lawful basis for waiving the interest owed by Goldman Sachs.

[14] NAO Report, Appendix One, Paragraph 78 [551].
[15] NAO Report, Paragraph 2.31 [531]
[16] NAO Report, Paragraph 2.43 [532]
[17] NAO Report, Paragraph 2.45 [533]
[18] NAO Report, Appendix One, Paragraph 78 [551].

G. Grounds

Breach of Litigation and Settlement Strategy

49. An oral agreement was reached between Mr Hartnett of HMRC and Goldman Sachs on 19 November 2010. That agreement did not include any element in respect of interest. As is now common ground, that was a substantial error.

50. The failure to include any interest element in the settlement was a breach of the Litigation and Settlement Strategy [250]. HMRC officials were required to deal with each dispute on its own merits, and prohibited from entering into "package deals". However, that is precisely what HMRC did. It accepted Goldman Sachs' proposal that "[HMRC] move on interest in return for [Goldman Sachs] conceding 100% of NICs" [D22]. The interest issue was not dealt with on its own merits. Mr Hartnett simply "recalled that there had been a significant technical weakness… but none of us could remember the detail". Without checking the legal advice, he simply conceded the point, in order to secure a wider settlement.

51. The NAO report confirms the breach of the Litigation and Settlement Strategy:

> "Sir Andrew Park's conclusion is that the overall settlement reached was reasonable… <u>Had the only issue been settling the employer's NICs liability and charging related interest, he would not have viewed the settlement as a reasonable one. However, when the settlement is viewed as one settlement covering six issues, including the interest issue, it was reasonable</u>"[19] (emphasis added).

52. This makes clear that the settlement by payment of NICs without interest was unreasonable, and could not have been justified on its own merits. The waiver of interest could only be justified as part of a package deal, and would not have been so

[19] NAO Report, Paragraph 78 [551]

settled if it had been considered on its own. It therefore was not settled on its own merits, in breach of the LSS policy.

53. The NAO appear to criticise this element of the policy. However, a policy must be applied equally to all taxpayers unless and until it is changed. Other taxpayers have for many years had to accept the burden of the policy prohibiting package deals. Further, the strategy is in its current form for good reason. As the current guidance accompanying the policy explains:

> *"No package deals*
>
> An even-handed approach across taxpayers is vital to securing good compliance on a sustainable basis. That rules out any sort of 'package deal' under which HMRC might be asked to concede one issue in return for the customer conceding another, irrespective of the merits, or where a range of issues are settled for a single payment that is not subdivided amongst individual disputes. Each separate dispute should be dealt with on its merits, but this should include any genuine interaction between one issue or another"[20] (emphasis added).

54. Further, in tax avoidance cases, where "our legal advice is strong", HMRC officials were instructed "not to accept settlements for less than 100% of the tax and interest due". In addition, where the case turns on a legal issue, disputes should be settled "on all or nothing terms: do not split the difference or offer any discount for an agreement not to litigate". This policy was not complied with. HMRC's legal advice was strong, but it nevertheless accepted a settlement without payment of interest, and reached a settlement on an all-or-nothing legal issue that in effect 'split the difference'.

55. The principle is that the HMRC does not make concessions where its legal advice is strong for the sake of a quick payment or to do a deal, but stands its ground. HMRC is prepared to litigate in order to recover what it believes is owed, and does not engage in "split the difference" settlements. This is designed to encourage good taxpayer behaviour and prevents taxpayers thinking that they can engage in ordinary commercial negotiations with HMRC rather than simply pay the full sum owing under the law, plus interest. HMRC's agreement to reduce the amount payable to the net

contributions in return for payment amounted to "split[ting] the difference or offer[ing] [a] discount" contrary to the policy.

56. The result in the present case is particularly egregious (or, as HMRC's General Counsel accurately put it, "unconscionable") because:

a) All of the other companies that used the scheme settled in 2005.

b) Goldman Sachs did not settle for another 5 years, having been warned in writing by HMRC in 2005 (when HMRC offered to settle with other scheme users) that interest would continue to accrue.

c) No interest was charged, despite Goldman Sachs having had the benefit of the funds for an additional 5-year period.

d) Accordingly, the settlement reached did not comply with what HMRC in its response to the letter before action describes as the "key aim": "to influence taxpayer behaviour positively" (paragraph 13 of the Litigation and Settlement Strategy [252]).

57. The Litigation and Settlement Strategy is a published policy of HMRC. Absent good reasons, the policy ought to be complied with to ensure fairness between taxpayers. Further, if HMRC misunderstands or misapplies its own policy, the Court ought to correct it. The question of what a policy means and whether a public authority has acted in accordance with that policy are questions of law for the court. In *R (HA) (Nigeria)) v SSHD* [2012] EWHC 979 Singh J noted that the "*meaning of a policy is an objective matter*". Similarly, Brooke LJ giving the judgment of the Court of Appeal in *R* v *Derbyshire County Council, ex parte Woods* [1998] Env. L.R. 277 held at page 290:

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[20] http://www.hmrc.gov.uk/practitioners/lss-guidance-final.pdf

> "If there is a dispute about the meaning of the words included in a policy document which a planning authority is bound to take into account, it is of course for the court to determine as a matter of law what the words are capable of meaning."

58. In *R (Raissi)* v *SSHD* [2008] Q.B. 836 at [120] to [123] the Court of Appeal held that the role of the Court was not merely to determine what a policy could reasonably mean, but that it was for the Court to definitively determine what a policy in fact means. The meaning of a policy is a question of law.

59. The further issue is why HMRC elected to proceed with the settlement, even once it had realised that it had erroneously failed to include any interest element. HMRC claims that Mr Hartnett and Ms Dawes "properly evaluated" the "legal and wider tax collection risks arising out of the exceptional circumstances" (Detailed Grounds, para. 32) and thus reached a lawful decision to affirm the proposed settlement. As to this:

a) Mr Hartnett wrongly took into account irrelevant considerations, including his personal reputation, potential embarrassment to Ministers and embarrassment to HMRC. This vitiates the decision to proceed with the proposed settlement once the error had been identified.

b) Neither Mr Hartnett nor Ms Dawes considered the Litigation and Settlement Strategy before making their decision. They did not take into account that affirming the settlement would be a substantial departure from the Strategy, or the consequences of such a departure.

c) It is common ground that there were no significant legal risks in re-negotiating the proposed settlement. As HMRC's General Counsel advised, it was open to HMRC to go back and renegotiate to include interest, alternatively to proceed with litigation to recover the full outstanding sum (Detailed Grounds, para. 18). The proposed settlement was not binding.

d) HMRC also took into account "wider tax collection risks". In fact, there appear to be no significant tax collection risks had HMRC promptly corrected its errors and pursued its claim for interest. Large firms and tax professionals should already know that the High Risk Corporate Programme Board must approve all large settlements. Few (if any) large firms or tax professionals would be remotely surprised or concerned by HMRC applying its published Litigation and Settlement Strategy and seeking to correct its error and collect interest. If anything, prompt and robust correction of the error would be likely to <u>enhance</u> public confidence in HMRC's ability and willingness to collect tax and national insurance contributions due and its reputation for effective tax collection.

e) Mr Hartnett recalled that there was a "significant weakness in our technical position on interest" [D22]. The Goldman Sachs representatives "acknowledged that… but none of us could remember the detail". After the meeting, it became clear that there had been a common misunderstanding: there was no weakness in HMRC's technical position. In these circumstances, Goldman Sachs' allegation of 'bad faith' against named HMRC officials was entirely unjustified. It is difficult to understand why acceding to Goldman Sachs' demands reduced "wider tax collection risks". If anything, it sends the message that HMRC was willing to back down when faced with exposure of an error and embarrassment, in circumstances where HMRC had a sound legal position. This does nothing to improve taxpayer behaviour.

f) HMRC also took into account that "re-opening the 19 November settlement would damage significantly an already difficult relationship and this could mean lower tax payments in future" [Detailed Grounds 20(c)]. This is an irrelevant consideration. It would not have been proper to take into account that a taxpayer had a previously good relationship with HMRC and therefore to decide to re-open the proposed settlement. That would be unfair to the taxpayer that had taken the trouble to develop an open and co-operative relationship with HMRC. It is equally improper to permit Goldman Sachs to benefit from its poor relationship with HMRC.

g) Further, the relationship with Goldman Sachs was poor because of the aggressive conduct of Goldman Sachs, and not through any fault of HMRC. Goldman Sachs had "resisted for 5 more years… taking every conceivable point in the Tribunal, and putting up a 'stooge' witness when Mr [Mike] Housden was the obvious person to answer questions" [257]. Mr Housden was so difficult to deal with that "Steve Bunson as global head of tax had flown in from NY to keep Mike [Housden] under control and to settle matters if possible" [D22]. It is wrong in principle to permit a taxpayer to benefit from its (no doubt well-thought through and tactical) decision to adopt an aggressive and confrontational approach in its dealings with HMRC.

h) HMRC also took into account that Goldman Sachs threatened to "withdraw from the [Tax] Code [for Banks] if HMRC re-opened the settlement" [Detailed Grounds 20(d)]. This was an irrelevant consideration. Signing up to the Code was not part of the proposed settlement ("… he would recommend that GS sign up to Code but this in no sense part of a package" [D22]). No other bank received (or could fairly have expected) favourable treatment from HMRC as a result of signing up to this voluntary and unenforceable statement of general principles. It was therefore an irrelevant factor to take into account.

i) Finally, HMRC contends that other corporate taxpayers would be less willing to reach settlements with HMRC because "it was no longer possible to rely on an agreement reached with HMRC". This is far-fetched. Many of the leading cases on legitimate expectation involve tax disputes where it was alleged by large companies that the Commissioners "had breached a promise" made by HMRC [Detailed Grounds para. 20(e)] (e.g. *Re Preston* [1985] AC 835, *R v IRC, ex parte MFK Underwriting* [1990] 1 WLR 1545, Case C-62/00 *Marks & Spencer v Customs and Excise Commissioners* [2003] QB 866 and *Al-Fayed v Inland Revenue Commissioners* [2006] BTC 70). In any event, the "financial services community" is well aware of the requirements of the High Risk Corporate Programme, and for approval of proposed settlements.

60. For the same reasons:

a) The settlement breached section 5(1) of the 2005 Act [1000], placing responsibility on HMRC for the collection and management of revenue. The settlement formed no proper part of the exercise of HMRC's functions of collection and management.

b) The settlement breached the principle of equality. HMRC failed to treat like cases alike. Goldman Sachs was not required to pay any interest despite having had use of funds for an additional five years when compared to the numerous other users of the same scheme. Goldman Sachs was favoured.

Irrelevant considerations

61. Mr Hartnett took into account his own reputation, potential "major embarrassment" to the Chancellor of the Exchequer and the reputation of HMRC when approving the proposed settlement[21].

62. The potential for "major embarrassment" to

a) Mr Hartnett personally;

b) the Chancellor; and

c) HMRC

were irrelevant considerations.

[21] "The risks here are major embarrassment to the ChX, HMRC, the LBS, you and me, not least if GS withdraw from the Code" [D22].

63. Mr Hartnett:

a) Admits that he took into account "that withdrawal would have embarrassed the Chancellor, who had announced on 30 November 2010 that the top 15 banks including Goldmans had signed up to the Code" [Hartnett para. 10]. This alone is sufficient to make out the irrelevant consideration case.

b) Denies that he took into account his own personal reputation [Hartnett para. 12].

64. The best evidence of the factors in fact taken into account is the contemporaneous email sent by Mr Hartnett to his colleague on 7 December 2010 candidly setting out his views [D22]. The *ex post facto* evidence in his witness statement (which does not address this passage in the email) is not a reliable source. The principles were summarised by Stanley Burnton J in *Nash v Chelsea College of Art and Design* [2001] EWHC Admin 538:

> "34 In my judgment, the following propositions appear from the above authorities:
>
> > (i) Where there is a statutory duty to give reasons as part of the notification of the decision, so that (as Laws J put it in *Northamptonshire County Council ex p D*) "the adequacy of the reasons is itself made a condition of the legality of the decision", only in exceptional circumstances if at all will the Court accept subsequent evidence of the reasons.
> >
> > (ii) In other cases, <u>the Court will be cautious about accepting late reasons</u>. The relevant considerations include the following, which to a significant degree overlap:
> >
> > > (a) <u>Whether the new reasons are consistent with the original reasons</u>.
> > >
> > > (b) Whether it is clear that the new reasons are indeed the original reasons of the whole committee.
> > >
> > > (c) <u>Whether there is a real risk that the later reasons have been composed subsequently in order to support the tribunal's decision, or are a retrospective justification of the original decision. This consideration is really an aspect of (b).</u>
> > >
> > > (d) <u>The delay before the later reasons were put forward</u>.

> (e) <u>The circumstances in which the later reasons were put forward. In particular, reasons put forward after the commencement of proceedings must be treated especially carefully</u>. Conversely, reasons put forward during correspondence in which the parties are seeking to elucidate the decision should be approached more tolerantly" (emphasis added).

65. Applying these principles to the present case:

a) The reasons given in Mr Hartnett's witness statement are not consistent with his contemporaneous email.

b) There is a real risk that the later reasons have been composed subsequently to support the decision made, and are a retrospective attempt to justify the original decision.

c) There are no notes of the meeting at which the decision was taken. No attempt was made to reduce the reasons to writing for 3 months after the decision was taken [D50]. The final record dates from March 2011 and appears to be the product of numerous drafting comments ("… thank you all for your help. I have taken into the note almost all the suggestions" [D50]). Those comments have not been disclosed. No explanation has been offered as to why the reference to "major embarrassment" to Mr Hartnett, the Chancellor and HMRC were removed from the final note (even though it is now common ground that Mr Hartnett took into account embarrassment to the Chancellor).

d) In response to the pre-action letter, HMRC <u>admitted</u> that "legal, <u>reputational</u> and wider tax collection risks" had all been taken into account [776] (emphasis added). This passage was relied upon in the Grounds for Judicial Review [31/30-31]. In the Summary Grounds, the reference to reputational risks was omitted ("legal and wider tax collection risks" [59/22]). This omission was noted in the Response to Summary Grounds [68]. HMRC's position in the litigation has not been clear or consistent. This increases the danger of *ex post facto* reasons.

66. Given Mr Hartnett's concerns for his personal position, expressed in his email sent at 9.36pm on 7 December 2010, it was inappropriate for him to take the decision with Ms Dawes whether to reject the decision of the High Risk Corporate Programme Board and approve the settlement. This decision was taken at a meeting held at 11.15am on 9 December 2010, only 1 working day after the email.

67. It would no doubt have been embarrassing to Mr Hartnett and his officials to have to admit their mistake about interest and renegotiate the agreement. However, the reputation and standing of officials or of HMRC, and potential embarrassment to a Minister, is not a relevant matter to take into account when deciding to waive collection of several million pounds of interest on national insurance contributions.

N. Conclusion

68. For the reasons set out above:

   a) The settlement was reached in breach of the policy set out in the Litigation and Settlement Strategy.

   b) The settlement breached section 5(1) of the 2005 Act [1000], placing responsibility on HMRC for the collection and management of revenue. The settlement formed no proper part of the exercise of HMRC's functions of collection and management.

   c) The settlement took into account irrelevant considerations, including "reputational" risks to Mr Hartnett, the Chancellor of the Exchequer and HMRC.

INGRID SIMLER QC

BEN JAFFEY

<u>IN THE HIGH COURT OF JUSTICE</u>
<u>QUEEN'S BENCH DIVISION</u>
<u>ADMINISTRATIVE COURT</u>
<u>London</u>

B E T W E E N:

THE QUEEN on the application of

UK UNCUT LEGAL ACTION LIMITED
<u>Claimant</u>
-and-

THE COMMISSIONERS OF HER MAJESTY'S REVENUE AND CUSTOMS
<u>Defendant</u>

CLAIMANT'S SKELETON ARGUMENT

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