Neutral Citation: [2023] UKFTT 62 (TC)

Case Number: TC08704

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing

Appeal reference: TC/2018/02466
TC/2018/02737

INCOME TAX – tax treatment of redress payments – penalties for inaccuracies

Heard on: 10 October 2022
Judgment date: 13 January 2023

Before

TRIBUNAL JUDGE MCGREGOR
DEREK ROBERTSON

Between

I.A. BARNETT

D.J. FOX

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Jeremy Barnett, of counsel, instructed by Wine & Co Chartered Accountants

For the Respondents: Charles Bradley, of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. With the consent of the parties, the form of the hearing was V (video) using the Tribunal video hearing. A face-to-face hearing was not held because a remote hearing was expedient. The documents to which we were referred are a bundle of documents of 324 pages, and an authorities bundle of 167 pages.

2. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

3. This hearing concerned appeals from Mr Ian Barnett and Mr David Fox (the Appellants) against closure notices in relation to their 2014/15 self-assessment tax returns and associated penalties for inaccuracies in those returns. The substantive question related to the tax treatment of redress payments received by the Appellants under a redress scheme relating to mis-sold interest rate hedging products.

4. The facts of both Appellants were identical and therefore the cases were joined to be heard together.

EVIDENCE

5. In addition to the bundle of documents, we heard oral evidence from both Appellants, including answers to questions from the panel. Mr Bradley chose not to cross-examine either witness.

6. The Appellants had included in the bundle a witness statement from a Mr Jacob Rabinowicz. He was a solicitor at Teacher Stern LLP, who had advised the Appellants. He was, less than 14 days before the hearing, asked to attend in order to be cross-examined. Due to the date clashing with a Jewish holiday, he was not available. The parties agreed between themselves that his evidence was not core to the hearing and that it would not be in the interests of either party to postpone the hearing to a date more convenient for Mr Rabinowicz. Mr Jeremy Barnett recognised that because he was not available for cross-examination, we may choose to put little weight on the evidence in his witness statement.

7. The Appellants had, only a few days before the hearing, requested that the HMRC officer who had conducted the enquiries be made available for cross-examination. She had never made a witness statement. It was reported at the hearing that she no longer worked for HMRC and was not available on short notice. We make no inference from the fact she was not present at the hearing and HMRC did not seek to rely on evidence from her.

FACTS

8. The background facts to these Appeals were not in dispute.

9. Mr Fox and Mr Ian Barnett entered into a loan from Barclays to acquire a property, which was to be used by a company (of which they were the sole shareholders) which conducted a telecoms business, in 2007.

10. Between exchange and completion of that property transaction, Barclays encouraged them to also enter into a swap relating to the interest rate on the loan.

11. By 2009, the relationship between Mr Fox and Mr Ian Barnett and Barclays had gone sour. The Appellants made a complaint to Barclays about their treatment.

12. On 27 July 2012, Teacher Stern LLP, solicitors for Mr Fox and Mr Ian Barnett, issued a pre-action letter to Barclays.

13. On 9 August 2012, the Appellants were invited to put their proceedings against Barclays on hold in order to participate in the independent review process regarding interest rate hedging product (IRHP) mis-selling, which had been set up by the Finance Services Authority (the predecessor to the Financial Conduct Authority – we will refer to both as the FCA in this decision).

14. The Appellants agreed to do so and submitted a claim within the FCA review.

15. On 30 May 2014, Barclays made an offer to Mr Ian Barnett and Mr Fox of £443,592.69. We will expand on the details of what made up this offer later in the decision.

16. Mr Fox and Mr Ian Barnett accepted this offer.

17. The funds were paid, after deduction of income tax from the interest element of the redress payment, to Mr Fox and Mr Ian Barnett during the course of the 2014/15 tax year.

18. Both Appellants included the interest payments on their tax returns for 2014/15 but not the redress payment.

19. HMRC opened an enquiry into both returns on 25 August 2016, stating that the enquiry was focused on the tax treatment of the redress payments.

20. Closure notices were issued on 16 October 2017 which charged all of the amounts listed as "Basic Redress" on the offer letter from Barclays, to income tax.

21. Following an internal review, completed in early March 2018, appeals were notified to this Tribunal in late March 2018.

PARTIES ARGUMENTS

Appellants' arguments

22. In relation to the closure notice, Mr Jeremy Barnett submitted on behalf of the Appellants that part of the Basic Redress in this case was compensation for something other than the Appellant's liability to pay sums to Barclays under the swap. This submission was supported by:

(1) Statements from Mr Fox and Mr Ian Barnett that they believed that the settlement offer included more than simply refunds of the amounts paid under the swap;

(2) The Appellants had already commenced proceedings against Barclays before the redress scheme was set up and this claim included claims for damages for the mis-treatment of Mr Fox and Mr Ian Barnett at the hands of Barclays and consequential losses from the inability of their business to enter into new lucrative contracts as a result of reduced cash-flow due to the swap payments as well as claims for the mis-sold swap;

(3) The settlement could, if proper advice had been given, have been drafted in a different way that could have altered the tax position and more properly reflected the heads of claim being pursued;

(4) The Appellants were precluded from obtaining proper professional advice by the terms of the review programme, in particular that professional fees for advising on redress were specifically excluded from recovery under the scheme on the basis that such advice was unnecessary;

(5) This exclusion of proper advice was a contravention of the FCA's obligation to treat customers fairly;

(6) The Appellants were not encouraged or told as part of the redress scheme to consider the tax consequences of the settlement or even warned that it may or may not

be subject to tax. In their view it beggars belief that there was no mention of the recipients' tax treatment in the offer letter;

(7) The redress proceedings were unfair – the FCA had the upper hand and controlled the entire process. It would have been fairer to allow the customers to accept elements of the redress but pursue alternative claims for other elements, but customers were told they had to accept all or nothing;

(8) The Appellants considered the settlement offer long and hard and decided, after a long period of distress and financial pressure that it was the right thing to do to agree to the settlement so that they could move on with their lives and rebuild their business; and

(9) The Appellants would never have agreed to the settlement terms if they had known the basic redress amount was subject to tax.

23. Mr Jeremy Barnett also drew out, through questioning of the Appellants, their feeling of being badly treated by the FCA in the review process. Mr Fox observed that the whole process was designed to obfuscate and that the FCA had been reprimanded for its poor processes in this review since then.

24. Further, both Appellants expressed in both their written statements and their oral answers, their view that discussions had been had between the FCA, Barclays and HMRC about the tax treatment of the redress payments but these conversations had been behind closed doors.

25. Mr Jeremy Barnett expressed the view that it was strange of HMRC not to offer witness evidence to contravene this evidence in the witness statements.

26. Mr Jeremy Barnett also highlighted that since Mr Bradley had chosen not to cross-examine the witnesses their evidence must stand.

27. Mr Jeremy Barnett asked us to rely upon the decision in *Hexagon Properties v HMRC* [2022] SFTD 901 as an authority for us to take an objective approach in looking at what the basic redress payment was really for.

28. In relation to the penalty, Mr Jeremy Barnett submitted that the Appellants cannot be said not to have taken reasonable care in submitting their returns. This is because they had a genuine belief that the tax to pay on the settlement had already been paid by deduction and because nothing in the redress scheme process alerted them to the need to include the redress payment in their returns or to seek professional advice about the tax treatment of it.

29. He submitted that it would be unfair to penalise the Appellants for not taking advice on what to include in their returns when they were precluded from doing so by the nature of the offer made under the redress scheme.

HMRC's arguments

30. Mr Bradley, for the respondents, argued, in relation to the closure notices that:

(1) The key point was to establish what the redress payments were for. He quoted from *Wilkinson v HMRC* [2020] UKFTT 362 (TC) a summary of the relevant redress scheme offered by the FCA;

(2) The scheme provided for two types of loss:

(a) Payments the affected parties would not have had to pay if they had not been mis-sold the products; and

(b) Consequential loss – payments for an opportunity lost as a result of the payments they had made due to mis-selling;

(3) In a claim in civil litigation, the second of these heads of loss would need to have been pleaded in detail, but the redress scheme offered a different approach;

(4) Under the redress scheme the default option for compensating for consequential loss was to offer 8% interest on the amounts under the first head of loss;

(5) For those who felt that 8% did not represent their full loss, they had the opportunity to put in a claim for a different amount based on their facts, but they were warned that the amount paid out may be less than the 8% already offered;

(6) In this case, there is no dispute as to the tax treatment of the 8%, which was returned on both of their self-assessment tax returns as interest, but only the tax treatment of the basic redress amounts;

(7) There also does not appear to be any dispute regarding the principles of the chargeability of the redress payments as decided in *Gadhavi v HMRC* [2018] UKFTT 600 (TC) and *Wilkinson;*

(8) There is no sustainable evidence that the redress payments were for something other than the excess payments under the swap that would not have been paid if they had not been mis-sold, in particular:

(a) The offer letter from the FCA scheme notes the consequential losses that were claimed. Claims were made for financial fees (which were allowed) and legal and accounting fees (which were not);

(b) These were the only matters claimed under the heading of consequential loss and therefore it is not sustainable to argue that other lost business opportunities were in fact the subject of the compensation; and

(c) There is little evidence of the original claim made against Barclays before entering into the scheme other than one page of the pre-action letter that was in the bundle and the witness evidence from the Appellants;

(9) In addition:

(a) if the compensation were for trading losses sustained, the compensation would be taxable as trading profit and therefore would not change the amount being pursued;

(b) any lost opportunity was in the company carrying on telecoms not sustained by the Appellants in their personal capacity or in their property business;

(10) Finally, the case of *Hexagon* is not relevant to this case because it dealt with a preliminary issue specific to the application of the loan relationship rules (which apply only to companies) and explicitly did not decide on the tax treatment of damages.

31. On the penalties, Mr Bradley submitted that:

(1) The pre-condition for the application of a penalty (namely the understatement of tax on the returns) has been met;

(2) It is common ground that both the Appellants did not inform their accountants that they had received a redress payment;

(3) HMRC accept the Appellants' evidence that they believed that they didn't need to include the payment on their returns;

(4) This was not a reasonable course of action in the circumstances because a prudent and reasonable taxpayer in receipt of a large and unusual payment would have told their accountants about it because:

(a) The offer letter is clear that tax has only been deducted from the interest element;

(b) The absence of a statement on the tax treatment of the redress payment is not sufficient to justify a conclusion that there is no tax to pay.

DISCUSSION

32. Given the core of this dispute is about the treatment of the money received by Mr Fox and Mr Ian Barnett under the FCA scheme, it is helpful to set out the elements of the offer letter:

33. The offer letter from Barclays was dated 30 May 2014. After an introduction making it clear that it is a second offer letter following a request from Mr Fox and Mr Barnett for Barclays to carry out an assessment of the consequential losses they were claiming. The letter reads as follows:

> We have now completed our assessment of the consequential losses that you are claiming in your Consequential Loss Questionnaire (CLQ) and I am writing to provide you with a redress offer incorporating an amount for the consequential losses which we have determined are payable to you. The terms of this redress offer are contained in this letter as well as the enclosed Redress Offer Summary and the enclosed Redress Offer Acceptance Form. The enclosed Redress Offer Summary and Redress Offer Acceptance Form enclosed with this letter replace the Redress Offer Summary and Redress Offer Acceptance Form enclosed with the Initial Offer Letter.
>
> Our redress offer is £443,592.69 with a deduction made for income tax[1] as outlined in the Redress Offer Summary. This is inclusive of compensatory interest (which is offered as compensation for the opportunity cost of being deprived of money you paid in relation to your missold IRHP). Please refer to the enclosed Redress Offer Summary for a breakdown of how this redress offer amount has been calculated.
>
> This redress offer before any deductions (as specified in the Redress Offer Summary):
>
> (i) includes all payments made by you under your IRHP, resulting from my decision that the sale of your IRHP did not meet the relevant regulatory standards agreed with the FCA for the purposes of the review; and
>
> (ii) includes interest at 8% simple per year on all refunded IRHP amounts for a period up to and including 90 days following the date of the Initial Offer Letter. This interest offer is intended to compensate you for the opportunity cost of being deprived of money (i.e. for any interest on borrowings and/or associated arrangement fees incurred in order to make payments under your IRHP and/or lost profits/opportunities you incurred because you were required to make payments under your IRHP). Please refer to section 5.1 of the 'Customer Guidance on Consequential Losses' which explains how this 8% simple interest per year is calculated; and
>
> (iii) includes any amounts due to you in respect of successful claims for losses other than (i) costs of borrowing incurred in order to make payments under a missold IRHP and/or (ii) lost profits/opportunities caused by the missale of the IRHP as well as any interest you might be offered on such

amounts. A full explanation of the decision by the Bank to award £2,100.00 (excluding compensatory interest) in respect of consequential losses is set out in the enclosed Consequential Loss Decision document.

The footnote read: "Income tax of 20% will be deducted from payment of compensatory interest pursuant to the income tax deduction provisions In the Income Tax Act 2007 in respect of compensatory interest (for further information on compensatory interest please see section 5 of the Customer Guidance on Consequential Losses')."

34. After some further information about interest rate risks for those with remaining loans outstanding and the procedures for accepting the offer, the letter includes the following statement:

> Please note that, by accepting this redress offer, you will be agreeing that this redress offer is in full and final settlement of all complaints, claims and causes of action in any way connected to the sale of your IRHP.

35. There are two invitations in the letter to call to speak to someone if there are any questions and, finally, an apology that the Bank did not meet the relevant regulatory standards.

36. The Consequential loss decision follows, which allows a claim for £2,100 for financial consultancy fees because "professional advice was required as a direct consequence of the missale of the IRHP".

37. The Consequential loss decision refuses claims for:

(1) £3,200 for accountancy work on the basis that they were incurred by the company run by Mr Fox and Mr Barnett, which was not a customer under the IRHP; and

(2) £24,707.10 for legal fees from Teacher Stern, on the basis that:

(a) "This claim relates to costs incurred in relation to advice received in respect of the review.

(b) "The review is intended to be a straightforward process and therefore the Bank does not consider professional advice to be a necessary consequence of the missale of an IRHP. It will therefore not provide compensation for professional advisers' fees incurred after 29 June 2012, except in exceptional circumstances (for example, where the Bank is satisfied that a customer would not be able to understand their redress offer without professional advice). This position is consistent with the FSA's (now the FCA) announcement on 29 June 2012 which confirmed that the IRHP review was intended to be straightforward, that the services of third-party advisers were unlikely to be required, except in exceptional circumstances, and that the Independent Reviewer is required to consider and confirm the appropriateness of any redress offer the Bank makes. Your circumstances are not exceptional and the services of third-party advisers were therefore unnecessary. Therefore no redress is payable."

38. Finally, there is a summary table as follows:

Breakdown of your redress offer	Cancellable Interest Rate Swap Trade date – 31/08/2007
Redress offer	Termination
Basic Redress	**£371,669.18**
Compensatory interest on basic redress up to 14/02/2014	£79,296.54
Compensatory interest on basic redress for an additional period of 90 days from 14/02/2014, i.e. up to 15/05/2014	£7,331.56
Total compensatory interest on basic redress	**£86,628.10**
Consequential losses	
Total consequential losses	**£2,100.00**
Compensatory interest on applicable consequential losses up to 15/05/2014	£651.29
Total compensatory interest on applicable consequential losses	**£651.29**
Summary	
Total Redress (basic redress and applicable consequential losses)	**£373,769.18**
Total compensatory interest (on basic redress and on applicable consequential losses)	**£87,279.39**
Total Redress offer before deductions	£461,048.57
Deduction for income tax from compensatory interest[1]	(£17,455.88)
Total redress offer[2]	**£443,592.69**

[1] Income tax of 20% will be deducted from payment of compensatory interest pursuant to the income tax deduction provisions in the Income Tax Act 2007 in respect of compensatory interest (for further information on compensatory interest please see section 5 of the 'Customer Guidance on Consequential Losses').

[2] This Redress Offer Summary should be read in conjunction with the Consequential Loss Decision which explains the Bank's decision in respect of your claim for consequential losses.

39. The parties were in agreement that if the basic redress amount (the £371, 669.18 set out at the top of the table above) is to be treated as a payment to refund of all the amounts that would not have been paid by the Appellants had they not entered into the mis-sold swap, then it is subject to income tax and should have been included on their self-assessment returns.

40. Mr Jeremy Barnett also expressly conceded that the principles set out in the *Wilkinson* case were accepted by the Appellants. However, he sought to argue that the facts of Mr Barnett and Mr Fox could be distinguished from those in *Wilkinson* because they had started litigation, whereas there was none commenced or threatened in *Wilkinson.*

41. He also sought to rely on *Hexagon* "for its facts" as the basis for encouraging this Tribunal to look at the position of the parties objectively and in the round and as an example of how a settlement agreement to compromise litigation can be drafted in such a way to suit a taxpayer, much more effectively than had been the case for Mr Fox and Mr Barnett. Further he said that it is evidence to support their arguments that the settlement under the redress scheme is a settlement of a potential claim under litigation.

42. This submission forms part of the overall question of what the basic redress amount was for. Mr Bradley argues it was for what was set out in the letter, i.e. refund of amounts spent and there was no evidence it was for anything else.

43. We accept that there is evidence of an increasingly poor relationship between Mr Fox and Mr Barnett on the one hand and Barclays on the other and that, by 2012, this had reached the point of pursuing a claim against Barclays in civil litigation.

44. As Mr Bradley says, there is limited documentary evidence before us as to the scope of that claim, but we had unchallenged evidence from both Appellants that the scope was wider than mis-selling and covered complaints about their treatment more generally, including the classification of their business as being at risk, with the consequent negative impact on their banking arrangements. We accept that this was the case.

45. However, when Mr Fox and Mr Barnett decided to enter the FCA redress arrangement, they put that civil claim on hold.

46. When the redress offers were made to them, they had a choice either to accept the offer made or not. At the stage of the first offer, they did not accept the offer, but submitted additional amounts for consideration, one of which was accepted, as set out above.

47. When the second offer was made, they decided to accept the offer. Both Appellants' evidence was that this decision was a difficult one to make, but that after such a significant financial and personal impact on their lives over such a long time, they decided that, on balance, it was better to move on with their lives and accept the offer.

48. At that time it would still have remained open to them to refuse the offer and revert to their civil claim. No doubt the associated risks and costs of pursuing such litigation fed into their decision to accept the offer. Both men knew that by accepting the offer, they were drawing a line under that option.

49. Mr Jeremy Barnett conceded that this Tribunal had no jurisdiction to consider or ameliorate the perceived unfairness of the FCA redress programme, but did invite us to find that the Appellants were excluded from obtaining professional advice regarding their redress scheme, as evidenced by the fact that a claim for legal fees was excluded. Further if they had had the relevant advice they would have structured it differently.

50. We cannot accept these arguments. The Appellants were not prevented from obtaining proper advice and professional advisers were not excluded from the proceedings. It is correct to say that the redress scheme declined to refund legal and accounting fees on the basis that the FCA did not believe that such advice was necessary. However, a general position that professional advice was not necessary is not the same as preventing or excluding it.

51. Whether or not Mr Fox and Mr Barnett would have taken a different approach if they had had advice at the time on the tax treatment of their redress payments is speculation. They did not seek tax advice and they accepted the redress offer that was presented to them in its entirety.

52. We do not believe that the position in *Hexagon* assists these taxpayers. As Mr Bradley pointed out, the decision explicitly did not reach a conclusion on the tax treatment of the settlement (see paragraph 3 of the decision), only a preliminary question on the loan relationship rules (which would be irrelevant in this case since they only apply to companies). We would also distinguish this case from being relevant, as Mr Jeremy Barnett submitted, as to the approach that a tribunal should take to the treatment of these redress payments as a matter of fact. The fact pattern in *Hexagon* was fundamentally different – the parties had taken part in the FCA redress scheme and received sums under it, however the settlement that was under

consideration in the appeal to the Tax Tribunal was a settlement of a subsequent claim for damages against the bank.

53. Mr Jeremy Barnett is of course correct that *Hexagon* is an example of how a settlement of litigation can be structured and drafted. However, the example does nothing to further Mr Fox and Mr Ian Barnett's case because we are considering the redress offer that was made to them and not a theoretical settlement that might have been made if they had been differently advised.

54. Having considered all of these points, we find that the payment of the basic redress amount of £371, 669.18 was to refund of all the amounts that would not have been paid by the Appellants had they not entered into the mis-sold swap, as set out in the redress offer letter.

55. Therefore we uphold the closure notices.

56. Turning to the penalty appeals, we must consider whether Mr Fox and Mr Barnett had taken reasonable care in completing and submitting their tax returns. If they have taken reasonable care, the penalties do not arise.

57. We would agree with Mr Bradley that the key question to answer here is whether the actions of Mr Fox and Mr Barnett were a reasonable course of action by reference to a prudent and reasonable taxpayer in the position of the taxpayer in question.

58. We have already decided above that they were not precluded from taking advice on the tax treatment of the redress payments. In the context of the penalties, the Appellants seek to argue that the redress offer letter gave them the impression that there was no further tax to pay and that this belief was, at least partially, based on the footnote that explains that tax has been deducted from the interest payments.

59. As Mr Fox and Mr Barnett were at pains to point out, they were and are experienced businessmen. Any experienced businessman understands the difference between a payment of interest and a payment of other sums. It was not reasonable for them to conclude that the footnote (set out in full above) suggested that all tax had been paid on the whole sum received under the redress scheme. The footnote is explicit that it relates to deduction of tax from interest and there is nothing in the footnote, or indeed elsewhere in the letter, to suggest that this represented the entirety of the tax due.

60. They used professional advisers to complete their returns and they provided evidence that their usual course of action was to provide their accountants with all the relevant information and paperwork for the year in order to complete the return. However, on this occasion, despite providing them with the details of the interest paid to them (and tax deducted from it), they did not tell their accountants about the redress element of the payment. Experienced businessmen would not be used to receiving sums of several hundred thousand pounds without tax to pay on the receipt. It was not reasonable for them to leave out the basic redress amounts from information provided to their accountants for the purposes of completing their tax returns.

61. We find that their actions and omissions were not a reasonable course of action and therefore they had not taken reasonable care. Therefore the penalties for the inaccuracies in their returns are validly imposed.

Note about witness evidence

62. Mr Jeremy Barnett referred several times to the fact that Mr Bradley elected not to cross examine the two witnesses and that therefore their evidence must stand. This is, undoubtedly true and in fact, with regard to the statements of fact and expressions of their own beliefs regarding their tax position, Mr Bradley expressly accepted this position.

63. However, Mr Barnett also suggested that HMRC's decision not to call a witness to challenge the assertions in that witness evidence regarding HMRC's agreements or behind closed doors discussions as to tax treatment with either or both of the FCA and Barclays had the same effect, i.e. that this must stand as evidence of fact.

64. We feel that we must be robust in response to this suggestion. The comments made by Mr Fox and Mr Ian Barnett regarding what may or may not have happened between HMRC and third parties are assertions, that is they are guesses or speculation on their part. The witnesses themselves conceded that they did not know what had taken place between HMRC and Barclays and/or the FCA. HMRC's decision not to call a witness to challenge those assertions does not have the necessary consequence that these assertions are shown to have been true. Mr Bradley did not address these points at all in his submissions. He would not have been at liberty to challenge the Appellants' belief in these things. However, their evidence is not evidence of the underlying facts of activities that, by their own evidence, they were not party to.

65. In terms of our decision, we do not find that the existence or absence of these alleged discussions are relevant at all to reaching our conclusions. The tax treatment of payments is prescribed by law and this Tribunal's role is to determine the facts and apply the law to them.

DECISION AND DISPOSITION

66. For the reasons given above, we refuse the appeals of Mr Fox and Mr Barnett against the closure notices and the penalties.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

67. 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.

ABIGAIL MCGREGOR
TRIBUNAL JUDGE

Release date: 13th JANUARY 2023