Standing in the Chancellor's Shoes: Equitable Remedies in the Tribunals

COMMENTARY BY DANIEL PETRIDES, 17TH MARCH 2021

Regular readers of this eBriefing will need no persuading of the labyrinthine nature of English tax law, even by the standards of Chancery practice. It is therefore unsurprising that taxpayers (particularly those without the benefit of professional advice) frequently make innocent mistakes which have significant adverse tax consequences, whereupon they often turn to the courts for assistance in seeking to unwind those mistakes.

The approach of the courts in such cases has, of course, been authoritatively re-stated by Lord Walker in *Pitt v Holt* [2013] UKSC 26. In short, where a party makes a causative mistake (which is to be distinguished from mere ignorance and inadvertence) of sufficient gravity as to the legal character or nature of the transaction, the court may intervene to cure the injustice arising.[1] Although in *Pitt* itself the Supreme Court set aside the transactions in question, it is uncontroversial that the full range of the court's equitable remedies may be engaged depending on the facts of any particular case.

At High Court level and above this presents no difficulty: by virtue of the Judicature Acts and their legislative successors, those courts possess the inherent equitable jurisdiction of the old Courts of Chancery.[2] However, much tax litigation is now conducted in the tribunals which, being creatures of statute, lack the inherent powers

[1] [101]ff., approving Lindley LJ's remarks in *Ogilvie v Littleboy* (1897) 13 TLR 399 at 400.

[2] Or, perhaps more accurately, the jurisdiction is confirmed rather than created by the Judicature Acts – see *Fourie v Le Roux* [2007] UKHL 1 at [25] as per Lord Hope.

of the Senior Courts.[3] It might, therefore, be thought that the tribunals are incapable of relieving a taxpayer of the consequences of their mistakes. The case of *Lobler v HMRC* [2015] UKUT 0152 (TCC) presents an intriguing attempt to circumvent this problem.

The facts of *Lobler* were stark. Mr Lobler had invested his life savings in various life insurance policies with Zurich Life. In 2008, he sought to withdraw a large part of those savings from the polices for the purpose of purchasing and renovating a family home. The withdrawals were, in accordance with a provision in the insurance contract, effected by way of a partial surrender. Unbeknownst to Mr Lobler (who had not taken professional tax advice), the consequence of effecting a partial (as opposed to a full) surrender was to trigger a 'chargeable event' for the purposes of the Income Tax (Trading and Other Income) Act 2005, with the result that the sums withdrawn were taxable under the statutory formula at an effective tax rate of 779%. As the FTT explained, this meant that *"he has made no profit or gain as that term is commonly or commercially understood, yet he becomes liable to pay tax which exhausts his life savings and may bankrupt him".*[4] Despite finding this to be a *"repugnant"* and *"outrageously unfair result"*, the FTT felt compelled to dismiss Mr Lobler's appeal against HMRC's assessment *"with heavy hearts".*[5]

Proudman J, sitting in the UT, allowed Mr Lobler's appeal against the FTT's decision. While she acknowledged that the tribunal itself could not order rectification – and it is trite law that equitable remedies only take effect with an order of the court – she found that if Mr Lobler had applied to the High Court, the instrument effecting the partial surrender would have been rectified to effect a full surrender so as to give effect to his true 'intention'. This being so, she held that by application of the ancient maxim 'equity treats as done that which ought to be done', it was open to the tribunal to conduct the appeal against HMRC's assessment of Mr Lobler's tax position on the basis that such a remedy had been granted. (Alternative grounds seeking rescission of the

[3] Whereas s.38 of the County Courts Act 1984 permits the County Court to make any order which the High Court could have made, no equivalent provision appears in the Tribunals, Courts and Enforcement Act 2007 or ancillary statutory instruments. cf. s.48 of the Arbitration Act 1996, which allows the parties to agree upon the remedies open to the arbitral tribunal.

[4] [3].

[5] [3]-[4]; [28].

contract with Zurich on the basis of bilateral mistake and alleging a violation of Mr Lobler's A1P1 rights by HMRC failed).

While doubtlessly a fair outcome, this effort at justice by way of transubstantiation was a somewhat novel application of the maxim. As Proudman J herself noted, the cases cited to her – which included the (dissenting) speech of Lord Radcliffe in *Oughtred v IRC* [1960] AC 206 and the approval of his reasoning by the Court of Appeal in *Neville v Wilson* [1997] Ch 144 – all involved specifically enforceable contracts. Indeed, the most frequently encountered instance of the maxim is the grant of an equitable estate to a prospective purchaser of property prior to the formal transfer of legal title.[6] In that context, it operates to protect an innocent transferee for value form the risk of default or fraud by an unscrupulous or impecunious counterparty in the hiatus between exchange and completion. It is therefore a classic case of equity imposing a constructive trust to prevent unconscionable dealings with property by the legal owner. But this rationale also reveals the maxim's limitations: as Lindley LJ explained in *Re Anstis* (1886) 31 Ch D 596 *"…the obligation to do what ought to be done is not an absolute duty, but only an obligation arising from contract, that which ought to be done is only treated as done in favour of some person entitled to enforce the contract as against the person liable to perform it".* The question therefor arises of whether the maxim can operate in the context of a unilateral act rather than a bilateral transaction.

Proudman J's justification for finding that it could was truncated – she simply stated that because all equitable remedies are discretionary in nature *"there is no relevant distinction between specific performance and rectification for present purposes".*[7] This is difficult to follow; the application of the maxim in the specific performance cases did not depend on the discretionary nature of the remedy but rather on preventing unconscionable conduct.

The better argument is perhaps that, properly considered, specific enforceability has never in fact been a strict requirement for the maxim to apply. In *Tailby v Official*

[6] *Walsh v Lonsdale* (1882) 21 Ch D 9 (CA); although *Walsh* itself was in fact a case where the lessor was seeking to take advantage of the absence of a deed to avoid paying rent in advance in accordance with its terms, it has come to stand as a shorthand for the creation of such equitable interests in property.

[7] [50].

Receiver (1888) 13 App Cas 523 Lord Macnaghten described such a limitation as a "*fallacy*", while Simon Gardner has shown that the apparent restriction emerged from the protectionism of Chancery lawyers following the Judicature Acts, and had no basis in the older caselaw.[8] More recently, in *HR Trustees v Wembley* [2011] EWHC 2974 (Ch), Vos J applied the maxim to give effect to an amendment to a pension scheme's trust deed in circumstances where it had only been signed by four of the five trustees (in breach of the formal requirements for the exercise of the power of amendment under the instrument).[9] Therefore, while the underlying mischief at which the maxim is aimed will most frequently arise where there is a specifically enforceable contract with a third party, there is no principled reason why the court's jurisdiction to cure a mistake in a unilateral act – which also arises from the unconscionability of allowing a party to retain property – should not also be susceptible to its operation. Given that the editors of *Snell's Equity* have long advocated the abolition of the maxim on the basis that it provides a conceptually imprecise housing for an array of otherwise defensible rules, it would be undesirable if a fair and pragmatic solution to the tribunal's lack of jurisdiction were to be stymied by a mechanistic application of a restriction of questionable pedigree. It also avoids the unedifying spectacle of taxpayers having to issue parallel proceedings in another court to obtain an order for an equitable remedy before the hearing of their appeal in the tribunals.

Lobler's reach has been extended in two subsequent cases by the FTT. In *Hymanson v HMRC* [2018] UKFTT 667 (TC) the tribunal overturned a decision by HMRC to withdraw a fixed protection certificate on the basis that the High Court would have rescinded certain additional contributions made to a pension scheme which had inadvertently put the taxpayer in breach of the conditions for the granting of the certificate. Most recently, in *Fashion on the Block Ltd v HMRC* [2021] UKFTT 0306 (TC) the FTT directed HMRC to assess the taxpayer's tax position on the basis that an incorrect form which had been filed erroneously would have been rectified so as to be in the correct form entitling the taxpayer to relief.

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[8] Gardner, S., 'Equity, Estate Contracts, and the Judicature Acts: *Walsh v Lonsdale* Revisited' *Oxford Journal of Legal Studies*, Volume 7, Issue 1, Spring 1987, pp. 60–103.

[9] It should be noted that aspects of Vos J's reasoning were criticised by Newey J in *Briggs v Gleeds* [2014] EWHC 1178 (Ch), who suggested that a trustee should be treated "*as having done what he ought to have done only in favour or someone who would have been in a position to enforce the obligation*" (at [80]).

Both of these cases differ from *Lobler* in one important regard. In *Lobler* the tax consequences of rectification were automatic – the basis on which the tax had been assessed was rendered incorrect. In contrast, in *Hymanson and Fashion on the Block*, because the decisions under challenge were exercises of discretions by HMRC, the FTT had to take the additional step of saying that HMRC's decisions were vitiated by a failure to take into account the relevant matter of whether a competent tribunal would have granted rescission/rectification. This would appear to imply that HMRC itself could, and should, be forming its own view on these types of question when exercising such discretions. Given the relatively permissive approach of the courts to granting relief post-*Pitt*,[10] it might be hoped that in cases involving relatively obvious errors – which, it is suggested, *Hymanson and First on the Block* were – this would cause no difficulty and avoid the need for litigation. This is all the more so given that costs recovery in the tribunals is limited.

However, it appears that this is not happening. Indeed, in in *Tailor v HMRC* [2017] UKFTT 0845 (TC) Falk J was heavily critical of HMRC for having failed to take *Lobler* into account when exercising a discretion in respect of an vulnerable and cognitively impaired elderly taxpayer.[11] This seems to be because, despite having not pursued any appeal, HMRC considers that *Lobler* was wrongly decided.[12] This state of affairs is unhelpful for taxpayers embroiled in disputes with HMRC, and seems hard to square with HMRC's Charter duties to treat taxpayers fairly. The UT is a Superior Court of Record whose decisions are binding on the FTT,[13] and taxpayers ought therefore to be entitled to assume that HMRC will assess cases in accordance with the prevailing caselaw rather than its own divergent interpretation which it has not had the courage to test on appeal.

Cases such as *Lobler*, perhaps above all else, reinforce the case for tax simplification, which Emily Campbell has written about previously in this eBriefing (here). But in the meantime it is encouraging to see that there is still new life in old equity.

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[10] See for example *Freedman v Freedman* [2015] EWHC 1457 (Ch) (also a decision of Proudman J) and *Van der Merwe v Goldman* [2016] EWHC 790 (Ch), in which Morgan J set aside a transfer of property made in ignorance of changes in the law which had come into force just two days earlier.

[11] See [5]- [7].

[12] *Hymanson* at [81].

[13] s.3(5) of the Tribunals, Courts and Enforcement Act 2007.

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