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RE: CONTRELLA LIMITED ("CONTRELLA")

O P I N I O N

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1. The purpose of this Opinion is to confirm the advice given in Conference with my Instructing Agents and the client. This Opinion is solely for the benefit of Contrella and its current directors. If this Opinion is shown to any third party, it should be made clear to the third party that they should take their own independent legal advice in relation to the matters contained in this Opinion and that I do not assume any duty of care or otherwise to them.

This is the "liability problem". If the tax goes wrong, it's the mini-umbrella companies – the MUCs - who are primarily liable – the loss will lie with them (and HMRC). The MUCs are not clients, and have no recourse to Mr Goodfellow… and Mr Goodfellow concludes further down that Contrella will have no liability even if the tax goes wrong.

Note that the MUCs are referred to in the Opinion as "SCIs".

2. The background facts are set out in paragraphs 1 to 20 of my Instructions.

We don't have Mr Goodfellow's instructions. So we cannot know exactly what he

[2] NICA 2014 Section 2(7).

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was told, and must be cautious about making assumptions. However, in relation to the key parts of the analysis it is reasonably clear what Mr Goodfellow was told, and what he was assuming.

It is of critical importance that the SCI, Contrella and AA should assemble and retain the appropriate items of evidence in order to prove the facts set out in the Instructions.

Advising a client to retain key items of evidence is sensible advice, and perfectly proper. "Assembling" is a little problematic when, later, we get to "facts" which were not facts at all – particularly the purpose of the structure.

3. In this Opinion, I will first analyse the relevant legislation applicable to the availability of the Employment Allowance and the flat rate of VAT ("FRV") before going on to answer the specific questions in paragraphs 49 to 66 of my Instructions.

The summary of the law on the following pages is accurate and complete. We include it to show that the KC's erroneous conclusions were not caused by simply missing applicable legislation:

The Employment Allowance: relevant legislation

4. The National Insurance Contributions Act 2014 ("NICA 2014") section 1(1) provides:

   "*A person qualifies for an Employment Allowance for a tax year if, in the tax year –*

   (a) the person is a secondary contributor in relation to payments of earnings to, or for the benefit of, one or more employed earners, and

   (b) in consequence, the person incurs liabilities to pay

[2] NICA 2014 Section 2(7).

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secondary Class 1 contributions, under SSCBA 1992."

5. Sub-section (1) is subject to Sections 2 and 3 and Schedule 1 to the Act. These other sections and Schedule 1 set out cases in which a person cannot qualify for an Employment Allowance for a tax year. Section 2 contains a series of exceptions some of which are potentially relevant to some of the activities which may be carried on by the SCI.

5.1. Section 2(3) provides the liabilities to secondary Class 1 contributions are excluded liabilities if they are incurred in respect of an employed earner who is employed (wholly or partly) for the purposes connected with the secondary contributor's personal, family or household affairs.

5.2. Section 2(4) provides that liabilities to pay secondary contributions are excluded liabilities if they are incurred by virtue of regulations made under Section 4A of the Social Security Contributions and Benefits Act 1992 ("the 1992 Act").

5.2.1. Regulation 6 of the Social Security Contributions (Intermediaries) Regulations 2000 SI 2000/77 ("the Intermediaries Regulations") applies where:

"*(a) An individual ("the worker") personally performs, or is under an obligation personally to perform, services for another person ("the client"),*

(b) The performance of those services by the worker is carried out, not under a contract directly between the client and the worker, but under arrangements involving an intermediary, and

(c) The circumstances are such that had the arrangements taken the form of a contract between the worker and the client, the worker would be regarded for the purposes of Parts I to V of the Contributions and Benefits Act as employed in the employed earners' employment by the client."

5.2.2. Where these Regulations apply:

5.2.2.1. the worker is treated for the purposes of the 1992 Act and in relation

[2] NICA 2014 Section 2(7).

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to any amount arising from relevant payments and relevant benefits as calculated in accordance with Regulation 7 ("the worker's attributable earnings") as employed in employed earners' employment by the intermediary, and

5.2.2.2. the intermediary, whether or not he fulfils the conditions prescribed under Section 1(6)(a) of the 1992 Act for secondary contributors is treated for those purposes as the secondary contributor in respect of the worker's attributable earnings, and the provisions of Parts I to V of the 1992 Act are to have effect accordingly.

5.2.3. Regulation 5 contains an important definition of "intermediary" for this purpose:

> "*… means any person, including a partnership or unincorporated association of which the worker is a member –*
>
> *(a) whose relationship with the worker in any tax year satisfies the conditions specified in paragraph (2), (6), (7) or (8), and*
>
> *(b) from whom the worker, or an associate of the worker –*
>
> *(i) receives, directly or indirectly, in that year a payment or benefit that is not chargeable to tax as employment income under ITEPA 2003, or*
>
> *(ii) is entitled to receive, or in any circumstances would be entitled to receive, directly or indirectly, in that year any such payment or benefit.*"

6. Under the proposed arrangement, both Contrella and the relevant SCI will be companies. Accordingly, paragraphs (2) and (3) of Regulation 5 set out the relevant conditions as follows:

6.1. "*… The conditions are that -*

> *(a) the intermediary is not an associated company of the client, within the meaning of Section 416 of the Taxes Act 1988 by reason of the intermediary and the client*

[2] NICA 2014 Section 2(7).

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both being under the control of the worker, or under the control of the worker and another person; and

(b) *either –*

(i) *the worker has a material interest in the intermediary, or*

(ii) *the payment or benefit is received or receivable by the worker directly from the intermediary, and can reasonably be taken to represent remuneration for services provided by the worker to the client.*"

6.2. Paragraph 5(3) provides that a worker has a material interest in a company if the worker and/or his associates have a 5% plus participation interest in the company. In the present case, the worker will not have any shareholding in either Contrella or the SCI.

Transfer of the Whole or Part of a Business

7. There are specific provisions in Section 2 preventing a secondary contributor from claiming the EA, referred to in the provisions as P, where a business or part of a business is transferred to P in a tax year. Secondary Class 1 NIC liabilities incurred by P in the tax year are excluded liabilities if they are incurred in respect of an employed earner who is employed (wholly or partly) for purposes connected with the transferred business or part.[1]

7.1. For the purposes of these provisions, a business, or a part of a business, is transferred to P in a tax year if, in the tax year –

(a) *another person ("Q") is carrying on the business or part, and*

(b) *in consequence of arrangements involving P and Q, P begins to carry on the business or part on or following Q ceasing to do so.*"[2]

7.2. A business for this purpose includes anything which is a trade, profession or vocation for income tax purposes as well as a property business as defined in ITTOIA 2005 Section 263(6). An arrangement for this purpose includes any agreement,

[2] NICA 2014 Section 2(7).

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understanding, scheme, transaction or series of transactions whether or not legally enforceable.[3]

7.3. Therefore, the question will arise whether the proposed arrangements between Contrella and one or more of the SCIs involves Contrella ceasing to carry on the whole or part of a business and the SCI taking up the carrying on of that business. It would, however, appear that where these provisions apply they apply only to restrict the employer's allowance in the same tax year in which the part of the business is transferred.

Restriction on Employer's Allowance where two or more Companies are Connected Persons

8. Where at the beginning of a tax year, two or more companies which are not charities are connected with one another and apart from Section 3 such companies would each qualify for an Employment Allowance for the tax year, only one such company can qualify for an Employment Allowance for the tax year. Part I of Schedule 1 sets out rules for determining whether two or more companies are connected with one another for the purposes of Section 3(1). In light of this restriction, it is essential to the proposed arrangement that none of the SCIs is connected with Contrella or AA or any other SCI.

8.1. Under Part I of Schedule 1 paragraph 2 sets out the basic rule for determining whether two or more companies are connected with each other with that rule being specifically extended in particular circumstances set out in paragraphs 3 to 7 of Schedule 1.

8.2. Paragraph 2 provides that two companies are connected with one another if one of the two has control of the other or both are under the control of the same person or persons. For this purpose, "control" has the same meaning as in Part X of CTA 2010 Sections 450 and 451. The provisions of sub-paragraphs (1) to (3) of paragraph 2 are subject to paragraphs 3 to 6.

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3 NICA 2014 Section 2(8).

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8.3. Paragraphs 3 to 6 do not contain alternative tests for control. Essentially paragraphs 3 to 6 limit the circumstances in which Sections 450 and 451 would otherwise treat one company as controlling the other or both companies as being under common control. On the other hand, paragraph 7 does contain an alternative test for companies being connected with each other. Essentially, the effect of paragraph 7 is that if one company, Company A, is, by virtue of paragraphs 2 to 6, connected with a second company, Company B, and Company B is connected with a third company, Company C, by virtue of those same provisions, then Company A is to be treated as connected with Company C even if they would not otherwise be so connected.

Alterations to the Rules for determining Control

8.4. Paragraph 3 applies where the relationship between two companies is not one of "*substantial commercial interdependence*", as that expression is defined by paragraph 3 itself. Where there is not such a relationship, then, in determining for the purposes of paragraph 2 whether the companies are under common control, the provisions of Section 451(4) and (5) are to apply as if the person or persons, to whom rights or duties in relation to one or more companies could otherwise have been attributed, had no "associates". The effect of this provision is to narrow the circumstances in which the rights of associates can be relied on to give one or more persons control of one or more companies.

8.5. Paragraph 4 contains provisions whereby the existence of fixed rate preference shares held by a company could otherwise be taken into account for the purposes of determining whether one company is under the control of another. This provision will be of limited relevance to the present case because Contrella will have no shareholding any of the SCIs.

8.6. Paragraph 5 deals with the circumstances where one company, Company A, is a loan creditor of another company, Company B. Paragraph 5 provides that Company A is not to be treated as under the control of Company B for the purposes of paragraph 2 if:

8.6.1. there is no other connection between Companies A and B, and

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8.6.2. either Company B is not a close company, or

8.6.3. Company B's relationship to Company A as a loan creditor arose in the ordinary course of a business which Company B carries on.

There is equivalent provision for the circumstance where two companies would otherwise be treated as being under the control of the third, which third company is a loan creditor of each of the other two companies.

8.7. Paragraph 6 deals with the situation where Companies A and B are treated as being under the control of the same person by virtue of rights or powers held in trust by that person and there is no other connection between Companies A and B. In determining under paragraph 2 whether Company A and Company B are connected with each other, the rights and powers held by the trustee are ignored.

Test of Control in CTA 2010 Section 450

9.

9.1. Under Section 450 a person ("P") is treated as having control of a company ("C"):

"(2) if P –

"(a) exercises,

(b) is able to exercise, or

(c) is entitled to acquire direct or indirect control over C's affairs."

(3) In particular, P is treated as having control of C if P possesses or is entitled to acquire –

(a) the greater part of the share capital or issued share capital of C,

(b) the greater part of the voting power in C,

(c) so much of the issued share capital of C as would, on the assumption that the whole of the income were distributed among the participators entitle P to receive the greater part of the amount so distributed, or

(d) such rights as would entitle P, in the event of the winding up of C or in any other circumstances, to receive the greater part of the assets of C which would then be available for distribution among the participators.

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(4) Any rights that P or any other person has a loan creditor are to be disregarded for the purposes of the assumption in sub-section (3)(c).

(5) If two or more persons together satisfy any of the conditions in sub-sections (2) and (3), they are treated as having control of C.

9.2. Under Section 451 the following provisions are to apply for the purposes of determining whether one or more persons has control over another:

"*(2) A person is treated as entitled to acquire anything which the person –*

(a) is entitled to acquire at a future date, or
(b) will at a future date be entitled to acquire.

(3) If a person –

(a) possesses any rights or powers on behalf of another person, A, or

(b) may be required to exercise any rights or powers on A's direction or behalf,

those rights or powers are to be attributed to A.

(4) There may also be attributed to a person all the rights and powers –

(a) of any company of which the person has, or the person and associates of the persons have, control,

(b) of any two or more companies within (a),

(c) of any associate of the person, or

(d) of any two or more associates of the person.

(5) That the rights and powers which may be attributed under sub-section (4) –

(a) include those attributed to a company or associate under sub-section (3), but

(b) do not include those attributed to an associate under sub-section (4).

(6) Such attributions are to be made under sub-section (4) as will result in a company being treated as under the control of five or fewer participators if it can be so treated."

9.3. Under Section 448 an associate is defined in relation to a person ("P") as meaning –

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"*(a) any relative or partner of P,*

(b) the trustees of any settlement in relation to which P is a settlor,

(c) the trustees of any settlement in relation to which any relative of P (living or dead) is or was a settlor,

(d) if P has an interest in any shares or obligations of a company, which are subject to any trust, the trustees of any settlement concerned,

(e) if P –

(i) is a company, and

(ii) has an interest in any shares or obligations of a company which are subject to any trust, any other company which has an interest in those shares or obligations,

(f) if P has an interest in any shares or obligations of a company which are part of the estate of a deceased person, the personal representatives of the deceased, or

(g) if P –

(i) is a company, and

(ii) has an interest in any shares or obligations of a company which are part of the estate of the deceased person, any other company which has an interest in those shares or obligations."

9.4. Under Section 448(2) a relative is defined as meaning –

"*(a) a spouse or civil partner,*

(b) a parent or remoter forebear,

(c) a child or remoter issue, or

(d) a brother or sister".

10. Anti-avoidance Provisions

10.1. Under section 2(10) of NICA 2014:

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"*A person cannot qualify for an Employment Allowance for a tax year if, apart from this sub-section, the person would qualify in consequence of avoidance arrangements.*"

10.2. Sub-section (11) provides:

"In a case not covered by sub-section (1), liabilities to pay secondary Class 1 contributions incurred by a person ("P") in a tax year are "excluded liabilities" if they are incurred by P, or are incurred by P in that tax year (as opposed to another tax year) in consequence of avoidance arrangements."

10.3. Sub-section (12) defines "avoidance arrangements" as

"*arrangements the main purpose, or one of the main purposes of which, is to secure that a person benefits, or benefits further from the application of the employment allowance provisions. For this purpose arrangements includes any agreement, understanding, scheme, transaction or series of transactions whether or not legally enforceable.*"

Legislation relating to the flat rate VAT ("FRV") Scheme

11. The flat rate scheme is contained principally in Part VIIA of the VAT Regulations 1995 SI 1995/2518 ("the 1995 Regulations").

11.1. Under Regulation 55L a taxable person shall be eligible to be authorised to account for VAT in accordance with the scheme at any time:

"*if –*

(a) there are reasonable grounds for believing that the value of taxable supplies to be made by him in the period of one year then beginning will not exceed £150,000, and

(b) he is not a tour operator,

(c) he is not required to carry out adjustments in relation to capital item under Part XV or

(d) he does not intend to opt to account for VAT chargeable on a supply made by him by reference to the profit margin on the supply, in accordance with the provisions of any Order made under Section 50A of the Act,

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(e) he has not, in the period of one year preceding that time –

(i) been convicted of any offence in connection with VAT,

(ii) made any payment to compound proceedings in respect of VAT under Section 152 of the Customs & Excise Management Act 1979,

(iii) been assessed to a penalty under Section 60 of the Act, or

(iv) ceased to operate the scheme, and

(f) he is not, and has not been within the past 24 months –

(i) eligible to be registered for VAT in the name of the group under Section 43A of the Act,

(ii) registered for VAT in the name of the division under Section 46(1) of the Act, or

(iii) associated with another person.

Where a person has in the period of 24 months before the date of his application been associated with another person, he shall not be authorised to join the scheme unless the Commissioners are satisfied that such authorisation poses no risk to revenue.

11.2. It should be noted that under Regulation 55B the Commissioners

"*may, subject to the requirements of this Part, authorise the taxable person to account and pay for VAT in respect of his reference supplies in accordance with the scheme with effect from –*

(a) the beginning of his next prescribed accounting period after the date on which the Commissioners were notified … of his desire to be so authorised or

(b) such earlier or later date as may be agreed between him and the Commissioners."

11.3. The Commissioners may refuse to so authorise a person if they consider it is necessary for the protection of the revenue that he is not so authorised[4].A flat rate trader shall continue to account for VAT in accordance with the scheme until

[4] Regulation 55B

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his end-date. In addition under Regulation 55P the Commissioners may terminate the authorisation of a flat rate trader at any time if:

(a) they consider it necessary to do so for the protection of the Revenue or

(b) a false statement was made by or on behalf of, him in relation to his application for authorisation.

11.4. For the purposes of the FRV,

> "*a person is associated with another person at any time if that other person makes supplies in the course or furtherance of a business carried on by him, and –*
>
> *(a) the business of one is under the dominant influence of the other, or*
>
> *(b) the persons are closely bound to one another by financial, economic and organisational links*"[5]

There is an important absence here. No mention of the general anti-abuse rule. No mention of common law anti-avoidance principles. No mention of the *Halifax* VAT anti-abuse principle. Nor are these issues referred to later.

It's possible that Mr Goodfellow's instructions expressly asked him not to consider these issues – but if that's the case, he should have refused to advise. A cornerstone of a barrister's professional obligations is independence, and an independent barrister should not agree to say a structure works on the basis of ignoring clearly relevant law that may mean it does not work.

Will the SCIs be regarded as service companies?

12. Essentially this is the same question as whether Chapter 8 of Part II of ITEPA 2003 applies to a supply of services by an umbrella company. Whether the worker would have been an employee of the end-user of his services (the client) depends upon a range of circumstances, many of which will be fact-specific to the particular type of

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work which is being performed. However, if there is a genuine right of substitution such that the immediate supplier of the worker's services to the client is entitled to substitute one worker for another in the provision of the services, in my opinion, it is very unlikely that there will be a provision of personal services to which the Intermediaries Regulations apply or that the worker would have been regarded as an employee of the client if there had been a direct contractual relationship between them.

13. More significantly in the present context, it is unlikely that the Intermediaries Regulations can be relied upon by HMRC to treat any person in the supply chain as

[5] Regulation 55A(2).

being the secondary contributor for NIC purposes other than the SCI. The terms of Regulations 4 and 5 make it clear that the person which is to be treated as the intermediary for the purposes of the Regulations must have a relationship with the worker and must make payments directly to or for the benefit of the worker.

13.1. Under the proposed arrangement, and neither Contrella nor the agency will have any contractual relationship with the worker nor will either of them make any payments directly to or for the benefit of the worker. Contrella will have a contractual relationship for the purchase of services from the SCI which it will supply on to the agency which in turn will supply on, along with other workers' services, to the client.

Some of the above analysis is questionable, but it depends on the detail of the facts as set out in the Instructions, which we do not have. So we will proceed for the moment on the basis that it is correct.

13.2. Similarly, the agency will make a payment to Contrella for the provision of services and Contrella will make payments for the benefit of the SCI through a bank account held for the benefit of the SCIs by AA. In this regard, it will be very important to ensure that the payments made into this account become the

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beneficial property of the relevant SCIs rather than the workers. My understanding is that this will be so, because it will be out of this account that the SCIs will discharge their respective liabilities to output VAT, make payments for the accounting services rendered to it by AA, deduct and account for any PAYE and Class 1 NIC due in respect of the workers' wages, pay the balance of such wages to the worker and use the excess to provide some form of dividend return or bonus payment to the shareholder/ director of the particular SCI.

It's as this point that Mr Goodfellow fails to spot what is happening. AA has a pre-existing bank account. It will have completed AML/KYC documentation saying it is the beneficial owner of the account. It is purporting to transfer beneficial ownership of the account to thousands of companies owned by Philippine individuals. That is, at the least, going to be a breach of the bank's terms of business – possibly it amounts to fraud. Either way, it is an improper step to take, and Mr Goodfellow should have raised a red flag.

Mr Goodfellow also makes an important non-tax legal mistake here. For payments into the account to become the "beneficial property" of the MUCs requires a trust. A trust will not arise just because of the way the account is used. The fact that one account is used to "benefit" (in the broad sense) all the MUCs does absolutely not mean that the MUCs each have "beneficial ownership" (in the legal sense) of monies paid into the bank account. You would need a "bare trust" to be created on very precise terms – as a tax KC, Mr Goodfellow should be very aware of that. Hence it seems likely the structure would fail on this point of implementation.

In principle such a trust could be created – the rule in *Saunders v Vautier* means the MUCs (as beneficiaries of a bare trust) would be able to call for the money in the bank account at any time. We very much doubt AA wanted the MUCs to be able to do this.

So it looks like the trust point was missed by whoever designed the scheme and by Mr Goodfellow. But, even if they had spotted it, it is not clear this issue could

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have been solved without rendering the structure unworkable.

Has there been a transfer of the whole or part of the business from Contrella to SCI?

14. I do not think that this is a likely analysis. My Instructions indicate that where the SCI employs the worker, and in turn supplies the services of the worker, the normal position will be that Contrella will remain in the supply chain and will be the recipient of the services provided by the SCI and will in turn supply them on to the agency. Therefore, it will be very difficult for HMRC to characterise Contrella as having alienated part of its business to SCI even if, which is probably unlikely, the worker employed for SCI was formerly employed by Contrella. The more likely analysis is that Contrella is carrying on the same business as before but has merely found a different method by which it is carried on and that, by no longer entering into a contract of service in relation to one or more workers, it has not transferred a sufficiently identifiable part of its business. At most it has transferred an asset of that business to SCI. Where the particular Worker has not been previously employed by Contrella it is hard to say that Contrella has transferred anything to the SCI.

This seems very questionable given that, on a realistic commercial basis, the business that was carried on by Contrella is now carried on by the SCIs/MUCs. But again, as we do not have the Instructions, we will prudently proceed on the basis the analysis is correct.

Are Contrella and the SCIs Connected with Each Other?

15. The intention is that before any SCI starts business, the entire issued share capital in that SCI will have been issued or transferred into the legal and beneficial ownership of a person who is unconnected with either Contrella or the persons who control Contrella or with AA and the persons who control AA. The shareholder in the relevant SCI is likely to be a person resident in the Philippines.

This is an enormous red flag and we cannot understand why Mr Goodfellow did not raise it. Creating a very large number of UK companies and having them owned by Philippine individuals is highly unusual. It is a reasonable assumption that it is being done to make it difficult for HMRC to investigate the structure and make recoveries from individuals involved.

Incredibly, the opinion even recognises this point, saying (para 40.3 below): "HMRC will regard the chances of recovery against a director resident in the Philippines as being remote".

The opinion ignores the obvious problems with having foreign directors of a UK company

Let's imagine a hypothetical world where the KC's assumptions were correct, and each Philippine director was really exercising control over their MUC.

The effect of this is that the MUC is "effectively managed" in the Philippines, and not the UK. The double tax treaty between the UK and the Philippines therefore makes it a Philippine tax resident company. That has two significant consequences:

- It may trigger a somewhat complex HMRC notification obligation for ceasing to be UK tax resident (TMA 1970 s109B). Failure to comply results in penalties for the company and other companies/directors which control it - so HMRC could impose penalties on AA (although it could be argued s109B never applies beause the company was always Philippine resident.)
- Very likely it also triggers Philippine direct taxes (because, after all, this is now a Philippine company from a tax point of view).
- For the same reason, if the structure works as expected, the Philippine directors probably make the MUCs "belong" in the Philippines and not the UK for VAT purposes. That will complicate the UK VAT analysis. It could also very plausibly result in Philippine VAT.

In any normal structure, these are the kind of things people worry about. We'd expect the KC's opinion to discuss the "belonging" point, note the importance of considering the s109B notification issue, and to include a careful warning that the KC is not qualified to advice on Philippine tax/VAT, and so the parties should be seeking advice from local counsel. The absence of any consideration of these points is startling - the opinion is utterly casual about the extraordinary step of migrating 10,000 companies to the Philippines.

When sophisticated people engaged in a complicated transaction aren't concerned about normal tax planning, that is a red flag that something untoward may be going on. It's counter-intuitive but correct to say that lack of concern about usual tax matters is a potential indicator of tax evasion (or indeed other malfeasance).

It is, once more, possible Mr Goodfellow was asked not to consider these issues. Ordinarily a KC opinion is very clear where there are issues he or she is not advising on, even when they are small points – the KC understandably wishes to both protect himself, and avoid inadvertently misleading a client. The residence/belonging of the MUCs is not a small point, and (whilst not impossible) the context is such that we would be surprised if the Instructions asked Mr Goodfellow not to mention it,

The shareholder will also become the sole director of the relevant SCI. It is anticipated that the profits which will be generated by each SCI will be sufficient to provide a reasonable return on the monies paid by the shareholder to acquire the shares. The return will be provided in the form of a dividend or director's fees.

Mr Goodfellow at this point is not being realistic. Will the directors really have any control over the companies? If they do, then the structure does not work – because 10,000 companies will be doing 10,000 different things. But if they don't, are they actually the "sole directors"? Or is AA, Aspire, or someone else a "shadow director"? That is a company law concept where Mr Goodfellow would not have expertise; but he should absolutely be identifying the potential issue.

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16. Neither Contrella, AA nor Compass Star will provide any form of loans or financial assistance to the SCIs. The amount subscribed for the shares should provide each SCI with sufficient working capital to undertake the first contract and wait until the first payments are made.

This was an unrealistic assumption. How could thousands of Philippine individuals pay share subscription amounts, and provide "sufficient working capital"? They would unlikely to be willing to pay money up-front, and (even if they were) setting up payment arrangements would be difficult in practice.

So what in fact happened was that directors were hired on the basis that "we will never ask you for a single *centavo*". The funds came from a participant in the structure. That meant that the structure immediately failed, even on its own terms, with that person becoming a "loan creditor" and a common link between all the companies.

This was in reality an inevitable outcome. Mr Goodfellow should have realised that.

If Compass Star or AA allow any deferred payment terms for the services which they provide to the SCIs, the terms of such "credit" should not depart from those normally applied between parties dealing with each other at arm's length (e.g. 30 days from the time of the issue of an invoice which should be issued promptly following the completion of the services). The intention is to ensure that none of Contrella, AA or Compass Star becomes a "loan creditor" (as defined by CTA 2010 s453 of the SCIs). If an SCI were to borrow money or acquire capital assets on deferred payment terms, the lender/supplier would be a loan creditor. However, if they had merely supplied services for which they were owed money by the relevant SCI, those services were supplied on arm's length terms and did not consist of a right to receive

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income, they would not become "loan creditors" of the SCIs.

17. Under the proposed arrangement, Contrella will not be supplying any services from the SCI; rather it will be the recipient of services from the SCI. AA will be providing accounting and agency services and Compass Star marketing services.

We believe, but are not certain, that the "Compass Star marketing services" are the services to the directors. So it is possible that Mr Goodfellow did know some of the details of how Compass Star operated.

These services cannot be characterised as conferring on the SCI the right to receive income. Rather, they are simply inputs which facilitate the provision of the Workers' services by SCI and it is the provision of the Workers' services which generate the SCI's right to receive income

18. It will be important to show that the registered shareholder in the SCI is the beneficial owner of the shares and does not hold those shares as nominee for Contrella, AA or Compass Star or an associate of any of such persons. None of these entities nor their associates should provide loans to the shareholders to allow them to purchase the shares because the existence of such loans could be relied upon as evidence that the lender had influence over the shareholder or some future right to acquire the shares.

We do not know how it was documented, but we do know that the individuals did not in fact acquire the shares out of their own funds. It also appears that no dividend was ever paid, or contemplated would be paid, on the shares. In practice, the "shareholders" voted on the shares as instructed. Mr Goodfellow should have realised how unlikely it was that thousands of randomly recruited Philippine individuals would be actually purchasing shares with their own funds. This was all foreseeable – and it meant the scheme was always going to fail.

19. If none of Contrella, AA or Compass Star nor any of their shareholders or loan creditors, has any legal or beneficial interest in the shares of the SCIs nor are any of them a loan creditor of the SCIs, HMRC will have to rely upon the general words of section 450(2) to

show that the SCIs are under the control of either Contrella or AA. HMRC may well investigate the method of operating the SCI's business closely to see whether they can contend that de facto Contrella or AA exercises control over the affairs of one or more of the SCIs. Control for this purpose is the ability to make decisions in one's own interest over the sort of issues which are normally decided by shareholders (e.g. appointment of directors, liquidation, and approval of dividends).

It is at this point we would have expected Mr Goodfellow to mention common law anti-avoidance principles. The Court of Appeal provided a succinct summary in the 2013 Pollen Estate case:

> ***"The modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. This approach applies as much to a taxing statute as any other. In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole".***

In the context of this transaction, that would have meant asking whether the purpose of the Employment Allowance legislation was given effect by the proposed interpretation of the connected person rules. We think the obvious answer would that it was not.

Role of Shareholder Director in the SCI

20. However, it would be sensible to ensure that the director of each SCI has as much autonomy over the conduct of the SCI's business as practicable and that the authority delegated to AA to act on behalf of the SCI is as limited as possible and terms of the contracts which are entered into by AA acting as agent for the SCI fall within the terms of such authority and are subject to periodic review by the director/shareholder (i.e. the director is sent details of the contracts which are entered into and information as to the profits generated by such contracts in form of monthly management accounts). The

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terms of the agency agreement between the SCI and AA should be explained to and approved by the shareholder/director before it is put into effect, rather than being a fait accompli by which the SCI is bound at the time when the shares are acquired.

21. The director should be invited to make or approve as many decisions as practicable. For example, the PAYE and VAT returns should be approved by the director. Importantly, the director should have the ability to decide that the SCI will undertake other projects and/or not to supply the Workers' services to Contrella. I infer that it is unlikely that the director will decide to do this because such contracts offer a reasonably reliable means of generating profit. But there should not be any tie or restriction on the SCI being used for other purposes. The accounts and the dividends (if any) should be approved by the director. The advice provided by AA should be sufficiently detailed and clear that the director/shareholder can make informed decisions rather than act as a rubber stamp.

The above would be perfectly reasonable if we were talking about one or two companies staffed by professional directors. But this was thousands of Philippine individuals recruited en-masse. The process realistically had to be automated, and Mr Goodfellow should have realised that. The directors were always going to be rubber-stamping decisions made by the scheme participants – which is what happened. The "advice" would always have been just a façade.

Qualifications of the Shareholder Director

22. Clearly, if the director and shareholder is to make these decisions, he or she will be required to have a level of education and fluency in English so that they understand the information they are being provided with and can make the appropriate decisions. So, in finding suitable candidates, it would be sensible to have evidence of educational qualifications and proficiency in English, that they have appropriate communication systems (mobile phone and email address) to be able to respond to the information provided and that they are willing and able to devote the required amount of time to run the company properly. It will also be necessary to retain evidence of such shareholder directors making decisions.

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At this point, we depart from what would be normal for directors of special purpose companies. We have collectively advised on thousands of such companies. We have never had to say that the directors should be fluent in English. This raises the possibility that Mr Goodfellow knew what was going on in The Philippines (but, if he didn't, he should have suspected).

Reliance upon Paragraphs 3-6 of Schedule 1 to NICA 2014

23. In seeking to ensure that neither Contrella nor AA is connected with a SCI, as a practical matter, one should organise ownership of share and loan creditor rights so that they will not be connected even if sections 450 and 451 apply to their full extent, rather than rely upon the limitations set out in paragraphs 3 to 6 of Schedule 1 to NICA. Accordingly, care should be taken that a shareholder director of the SCI is not a relative or partners of any person who is a shareholder or loan creditor of Contrella, AA or Compass Star. Similarly, one should avoid any company being a shareholder or loan creditor of any SCI if the persons who control Contrella, AA or Compass Star also have a shareholder or creditor relationship with that company. If this is achieved, it will not matter, from a strictly EA perspective, if there is "substantial commercial interdependence" the SCI and Contrella for the purposes of paragraph 3, because taking account of their associates' interests will not alter the control analysis. Nevertheless, since the test whether companies are "associated" for FRV purposes is very similar, it is important to ensure that there are not close financial, organisational and economic links between them. This is discussed in more detail below in relation to the FRV scheme.

24. A similar analysis applies for the purposes of paragraphs 4-6.

Connection between Shareholder/Directors of SCIs for purposes of Paragraphs 2 & 7

25. This may easily overlooked, given the importance that there is not common control between Contrella or AA and any SCI. If a shareholder director of one SCI is a relative or partner of a shareholder director of another SCI, then, unless the requirements are satisfied, then, each will be associates of the other and since the rights of associates will be attributed to the shareholder director, each will be treated as controlling the other SCI,

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thus making the two companies connected.

In practice it seems some individuals did become directors of multiple companies; either Mr Goodfellow's advice was disregarded, or Compass Star/Contrella were incompetent.

Application of Avoidance Provisions & Relevance of Spotlight 24

26. This depends on whether a main purpose of the series of transactions is to secure the availability of the EA. The first two questions are:
    26.1. First, which transactions can be regarded as forming part of a series so as to form part of an arrangement; and
    26.2. Secondly, whether the test is an objective or subjective one.

27. HMRC are unlikely to rely simply on the agreements for the supply of services between SCI and Contrella and the contract of employment between the SCI and the Worker as constituting "the arrangement". This is because there are obvious commercial purposes behind both those agreement. The provision of the Worker's labour for reward and the re-selling of that labour for reward by SCI. They will want to include within the arrangements the steps by which Contrella decides not to employ the Worker but directs him to the SCI whilst staying in the supply chain. In order to include these transactions within the series, it will normally be necessary to show that they share a common purpose. The language of the test suggests that the steps within the arrangement can be characterised as having a shared set of purpose or purposes, whether they consist of a sole purpose, or two or more main purposes or a combination of main and subsidiary purposes. A step which did not at least share one purpose with the other steps could not sensibly be regarded as forming part of the same arrangement. However, this then raises the question from whose perspective is the purpose of a particular step to be ascertained.

28. The test does not expressly focus on the purpose of a particular party to the arrangements. This can be contrasted with some anti-avoidance provisions where the draftsman tends to make it clear which person's purpose is relevant to the application of

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the purpose test; see e.g. ITA 2007 s684(1)(c). The absence of a clearly identified person to whom the purpose test makes it less likely that test was intended to be a subjective one. On the other hand, the subsection does not adopt the language of more recently drafted taxation provisions which are intended to impose an objective test (see e.g. ITA 2007 s737(3): "..*it would not be reasonable to draw the conclusion from all the circumstances that the purpose of avoiding liability to taxation...*"). It is possible to argue credibly for both tests and I incline to the view the test is a subjective one with the main focus being on the purpose of the secondary contributor being party to the arrangements. In practice, a tribunal of fact will tend to have regard to what it perceives to be objective factors in assessing the credibility of the evidence it hears as to the secondary contributor's and other persons' purpose/purposes in entering the arrangement.

29. What constitutes the main purpose or purposes of an arrangement is in part a question of fact dependent on the particular facts of each case. However, on the basis of the propositions put forward in my Instructions, there are good grounds for contending that obtaining the EA is not a main purpose of the arrangements for the following reasons:

    29.1. Each of the parties to the arrangement can be fairly characterised as having an overriding commercial purpose in being party to the arrangements.

This is where the opinion takes a legal position that in our view is indefensible. Thousands of UK companies are being established with Philippine directors and shareholders, all coordinated by AA (under the agency agreement). This is a wholly artificial arrangement, and its only purpose was to avoid tax – in particular, to obtain the EA and the benefit of the VAT fixed rate scheme.,

So, are these "*arrangements the main purpose, or one of the main purposes of which, is to secure that a person benefits, or benefits further from the application of the employment allowance provisions.*"?

We think the answer is "obviously yes", and we cannot understand how anyone would expect a court to reach a different conclusion.

In the past twenty years, the courts have struck down almost every avoidance scheme they've seen (the sole exception being SHIPS 2), This scheme is plausibly more egregious than any that have come before the courts. The idea they wouldn't

say the main purposes including gaining the EA is risible.

Mr Goodfellow reaches this conclusion by not following the wording of the legislation, and asking what the main purposes of the arrangements are. Instead, he looks at the individual purpose of each company (which we would say is incorrect). He then says that the tax saving was commercially necessary; therefore it was not a "purpose" – it was a means not an "end". We think that is clearly incorrect.

First, on general principles, the argument has the disconcerting consequence that no SPV created for a specific tax avoidance transaction could ever have a tax main purpose.

Second, this is simply not the way the courts had, even in 2016, approached this question. The opinion doesn't consider a single case or other authority on "main purpose".

By 2016, there were several important cases. *Snell* (2008) had concerned the "main object" test in the transactions in securities rules, In that case, the High Court had focused on the tax-motivated elements of the transaction, considered that the relevant "arrangement", and because they were solely motivated by tax, had had no difficulty in finding that there was a tax main purpose.

In Sema Group Pension Scheme (2003), Lightman J considered the extent to which tax had to feature in the objects of a transaction to become a "main object". He concluded that "if the tax advantage is mere 'icing on the cake' it will not constitute a main object".

In *Lloyds TSB Equipment Leasing (No. 1) Ltd* (2014), the Court of Appeal held that, in a complex transaction where each element served a commercial purpose, the overall arrangement could still have a tax main purpose.

More recent caselaw (post-dating the opinion) has weighed the tax and non-tax benefits of a structure – so in Euromoney (2021), the tax advantage was less than

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5% of the overall sale consideration for the transaction, and the taxpayer spent relatively little time considering it – hence tax was found to be not a main purpose.

All of these approaches seem fatal for the structure. [1]

29.2. The SCI's purpose should be ascertained principally by reference to the benefit its director and shareholder derive from the arrangement. Its aim from being a party to the contract of employment and the contract for service is to take on and make profits from assignments other contractors cannot afford to undertake. Its lower liability to NIC may be a reason why it able to undertake the assignment profitably whereas other businesses cannot. But the saving of NIC cannot be characterised as an end in itself from the SCI's perspective or that of its owners because it has never been subject to the higher level of NIC nor is it realistic to attribute a level of business which exposed it that higher level of NIC. It would lose one of its major cost advantages and would not be able to generate enough business to justify paying its employees at a rate which attracted that level of NIC liability.

The counterfactual analysis here has never been part of the "main purpose" test.

29.3. The owners of SCI do not benefit in any way from the monies paid for the services provided by AA or Compass Star. Nor do they benefit from the margin made on the onward supply of the Workers' services by Contrella. So, it is fair inference that these benefits do not form part of its reasons for being party to the arrangement.

29.4. The Worker's purpose in being a party to the employment contract is to maximise his pay, both before and after tax. The Worker is not liable for the secondary contributor's liability for secondary contribution and so its minimisation

[1] Updated and expanded from original draft, which confused the *Lloyds TSB* and *Euromoney* cases – our apologies

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is unlikely to be part of his purpose in participating in the arrangement.

29.5. Contrella is not liable for the secondary contribution due on the Worker's wages. It does not benefit from the wages paid to the Worker or from the profits made by the SCI or from the fees that the SCI pays to AA and Compass Star. If it were not able to sub-contract the assignment to the SCI, I understand that it would lose the business entirely and so would not have the occasion to employ the Worker. In these circumstances, its sole or main purpose in being party to the arrangements would appear to earn the margin between the price it sells to the Agency and the price it pays to the SCI and preserve its commercial relationship with the relevant Agencies. It cannot be its purposes to secure the saving in NIC because without the arrangement, it would not have any liability to NIC in respect of the wages the Worker receives because the Worker would not be working for it or for the SCI.

Again, this is an irrelevant counterfactual. Obviously the purposes of the arrangement as a whole is to secure the NIC savings. What else is the purpose of the thousands of companies?

29.6. HMRC would have to contend that a main purpose of the arrangement was one none of the participants to the arrangements had themselves.

This seems unreal. Mr Goodfellow was sitting in a room with people who had contrived an artificial structure which served no purpose other than to avoid tax.

30. In my opinion, the purposes of the arrangements are readily distinguishable from that outlined in the Spotlight 24.

Spotlight 24 says the purpose of the scheme is for each mini-company to claim

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the full Employment Allowance. That is clearly the purpose of the scheme. It's unclear how Mr Goodfellow could come to a different conclusion.

30.1. First, it is not clear whether HMRC are relying upon the restriction in subsection 2(5) rather s 2(10) in denying the relief to the employing company. The former employer would appear to have transferred part of its business (viz all or most of its staff) to the payroll company and its small employing company whereas in the present case most of the Worker will not have worked for Contrella before and Contrella will remain in the supply chain, providing essentially the same service as before.

30.2. Secondly, in the Spotlight case, there is no suggestion that the former employer would not be able to engage in a line of business without being able to sub-contract the work to the payroll entities or that it would not be using the staff transferred to the payroll entities. Rather, it already employed the staff and would continue to do so. The purpose of the arrangement was simply to allow it to have the use of the staff to continue to service its existing level of business without paying the same level of NIC. In the present case, neither Contrella nor the SCI would be employing the staff because without the arrangement they would not have the business to require that level of staff. So, the reduced net liability to NIC was an incident of having the increased level of business and need for staff and not a purpose in itself. It will be critical to establish the absence of the additional business without the benefit of sub-contracting.

This is the "we wouldn't have had any business if it wasn't for the tax saving, therefore tax is not the main purpose". As discussed above, a corollary of this

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argument is that main purpose tests will rarely, if ever, apply to SPVs – which cannot be right.

It is also unclear why Mr Goodfellow is so confident that the same argument doesn't apply to the Spotlight scheme. We rather expect it would apply in exactly the same way – by definition, each "underlying company" (in the words of Spotlight 24) would not have existed but for the tax benefit.

The obvious conclusion was that the proposed scheme was materially identical that in Spotlight 24, meaning that an HMRC challenge was inevitable. We do not understand why Mr Goodfellow did not reach that conclusion.

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VAT: the Flat Rate Scheme

31. HMRC's primary concern will be whether the SCIs are or have been associated either with Contrella or AA during the previous 24 months.

 31.1. The SCIs will not be under the dominant influence of Contrella simply because it habitually trades with Contrella by supplying labour to it. HMRC accept that where a normal commercial arrangement subsists, the two businesses will not be associated with each other. It will, therefore, be important to show that the terms of the supply contract are at arm's length. Further, the SCIs should be free to refuse assignments and should be free to carry on other business transactions. It would be sensible for the SCIs to take advice from AA or another qualified adviser as to whether undertaking other business transactions would affect SCI's ability to claim the FRV and take that into account in deciding whether to proceed.

 31.2. HMRC may be sceptical of whether the SCIs are under independent management. Consequently, it will be important to be able to show that the assignments undertaken were in the interests of the SCI to do so and that the shareholder/director had sufficient information to make decisions and did in fact do so.

32. It should be noted that the test is whether one business is under the dominant influence of the other and whether the two taxable persons are closely bound to each other by financial, economic and organisational links. In order to minimise the chances that the second limb will preclude registration for the FRV, it will be important to show that:

 32.1. Contrella is neither a shareholder nor a lender to the SCIs.

 32.2. The directors and shareholders the two companies should be different.

 32.3. The employees of the two companies should be different.

 32.4. The finances of the two companies are separate. The sums due to the SCIs are paid to it (in form of a payment to its agent, AA) and it settles its own liabilities out of its own monies.

 32.5. The SCI, through AA, which is independent of Contrella, is able to monitor its own business and keep track of its financial position.

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33. In my opinion, if these matters can be established as well as the matters discussed above in relation to "dominant influence", then the SCIs will have a good case for showing that they are not closely bound to Contrella by financial and organisational links. There is a risk that close economic links between the two companies could be established because the SCIs habitually derive their business from Contrella and supply services to that company. However, this risk would be materially mitigated by showing that the contracts with Contrella are beneficial to the SCI, they are not compelled to enter into those agreements and they are free to take on other business activities. The use of the word "bound" in the legislation connotes an enduring and compelling link between the two companies which is inconsistent with the two companies being free not to engage in the relevant businesses and to pursue other venture. In addition, the test is whether the companies are closely bound by reference to a composite of three different, albeit overlapping links. If the SCIs are financially and organisationally independent of Contrella, and terms of trade between them are mutually beneficially and not exclusive, then, then Contrella and the SCI should not be regarded as closely bound.

34. A similar approach should be adopted to the question whether AA''s business exercises dominant influence over the SCI's or the two sets of entities are closely bound. Since AA's business is substantially advisory in nature and provides a different type of service than that supplied by the SCIs, there is less of an inference that it will be able to exercise dominant influence over the SCIs' businesses. However, it will be important to show that the director/shareholder does not have to accept the advice given to him by AA although it will be normal for him to follow such advice, particularly in relation to technical issues. The factors discussed above in showing that AA does not exercise "control" over the affairs of the SCIs will be relevant in satisfying this limb of the test.

35. Again, the absence of common shareholdings or financial loans between the two companies will assist in showing that there are not binding financial links between them. Due to the use of the client accounts to receive and discharge the SCI's receivables and payable, there is some evidence of close organisational links but this can be characterised as part of the service which AA provides to the SCIs. Because AA is not in

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the supply chain and does not contribute to the supply of services which constitutes the SCIs' businesses, I consider it will be difficult for HMRC to establish that there are economic links binding the two sets of companies together. Accordingly, I consider that there will be a good case for contending that the SCIs will not be regarded as being associated with AA.

36. It will be important to show that the SCIs are separately owned and managed from AA before each of the SCIs starts their respective businesses. Although AA may have been responsible for incorporating the SCIs, in my opinion, there is an implied limitation on the scope of the test in Regulation 55L(1)(d)(iii) that one is concerned with past association only if it existed whilst the company seeking registration under the FRV was carrying on a business:
    - 36.1. The test whether two persons are associated (as set out in Regulation 55A(2)) tests the existence of dominant influence or close links only at times where a person is making supplies in the course or furtherance of a business.
    - 36.2. The other limbs of the test in Regulation 55L (d) are clearly looking at the position where the person is already making supplies.
    - 36.3. A test which treated a company as being associated with another company within the last 24 months simply because one had incorporated the other would lead to absurd results because the FRV would be routinely denied to new companies simply because the incorporated agent had held the subscriber shares.

To recap the facts as Mr Goodfellow knew them (or should have known): the companies were established by AA. They were undertaking the business which Contrella would normally have undertaken itself. Their day-to-day business was entirely managed by AA, their agent. All their funds went through AA entities. The directors/shareholders realistically had to be centrally coordinated in an automated manner.

Given this, how could Mr Goodfellow conclude that the MUCs were not not closely bound to Contrella by financial and organisational links?

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In our view it's indefensible.

What's more indefensible is that Mr Goodfellow narrowly interprets the legislation as if it was 1960s English domestic law. This was EU VAT law in 2016, and the courts had established an anti-abuse principle in the *Halifax* case. Broadly speaking, the Halifax principle applies if an arrangement fulfil the letter of legislation, but result in a VAT advantage that's contrary to the purposes of the VAT Directive and implementing national legislation, and objectively the aim of the arrangements was to gain that advantage. The arrangements are then recharacterized to deny the VAT advantage. This is, therefore, not merely an approach to interpreting legislation, but a rule that applies on top of that legislation.

It is reasonably clear that Halifax would have applied in this case. We cannot understand why Mr Goodfellow did not even consider it. It is, again, possible that his instructions asked him not to. But a barrister's professional obligations of integrity and independence means that it is simply not proper to give an opinion that the law is a particular way, whilst pretending that a rule that casts this in doubt does not exist.

37. There is a risk, albeit I would estimate it to be a small one, that HMRC might rely on this past association as a ground for refusing or delaying the grant of the FRV. In order to reduce this risk further, I would suggest that the SCI's are incorporated upon the instructions of prospective purchasers of the shares on terms that AA is to hold the subscriber shares on trust for that purchaser. Consequently, at no time, would AA be the beneficially owner of the shares.

Discretion to refuse or terminate FRV Registration for the protection of the revenue

38. This is a discretionary power the exercise of which can be challenged on the grounds that HMRC have made their decision on the basis of some misdirection in law or

otherwise reached an unreasonable result. There is a risk, again which I would estimate as being small, that HMRC could exercise this power. Provided that the SCIs satisfy the tests for eligibility for registration under the FRV scheme and comply with its requirements, it would be unusual and possibly a misdirection for HMRC to refuse registration on the grounds that it was part of an arrangement which allowed a company to undertake a range of assignments which another business would not find it profitable to carry on, even if the effect of the arrangement would be to reduce the overall amount of NIC payable by the two companies.

Furthermore, NIC is strictly speaking not a tax and so may not fall within the ordinary meaning of "the revenue".

No authority is given for this statement, and it is probably wrong. The ordinary meaning of "the revenue" is HMRC. The common law offence of "cheating the public revenue" certainly applies to national insurance. So it seems likely that "protection of the revenue" includes national insurance, and all taxes, levies etc for which HMRC have responsibility.

39. The principal focus in determining whether the exercise of that power is justified is whether there is a threat to the net VAT receivable by HMRC, not other taxes and that such threat should arise otherwise than pursuant to the proper operation of the FRV. The mere fact that the proper operation of the scheme may lead to a reduction in the amount of VAT compared with the operation of normal method of deducting input tax from the normal level of output tax cannot be a reason for refusing or terminating the registration not least because it would require the business to operate the strict method of accounting in order to test the proposition, which is the burdensome task which the FRV was intended to spare small businesses. So, in my opinion, so long as the business of the SCI is allocated to the proper category for FRV purposes, and the scheme is properly operated thereafter, there should be a good case for resisting the refusal or termination of registration on this ground.

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This again suffers from failing to step back and consider the reality of the arrangement: an artificial scheme to split a business into thousands of companies, each claiming benefits meant for one small company. It seems clear that HMRC would (if appraised of the facts) use their "protection of the revenue" power.

Mr Goodfellow also perhaps misunderstands the role of tax tribunals when he says there is a "good case for resisting the refusal or termination of registration". An appeal against a "protection of the revenue" decision must be on (essentially) judicial review principles, i.e. that HMRC have acted in a way which no reasonable panel of Commissioners could have acted, or have taken into account an irrelevant factor, failed to consider a relevant factor, or erred in law. A "good case" that disagrees with HMRC's findings of fact is not enough.

Recovery of Unpaid NIC Against Directors and Officers

40. For the reasons set out in my Instructions, I agree that, if HMRC were able to show that additional Class 1 Contributions were due from one or more SCIs (so far as the increased liability was attributable to a denial of the EA) the ability of HMRC to recover that additional liability from other persons would be limited.

It appears from this paragraph that Mr Goodfellow was asked to confirm that, if the structure failed technically, HMRC would not in practice be able to recover liability from the people behind the structure. It is most unusual for a lawyer to be asked to provide advice of that kind – none of our team can recall it. It raises several immediate red flags – first, that the parties expect to be unable to defend a structure technically; second, that they then plan to walk away from it; third, that they are relying on the Philippine element to make HMRC's recovery impossible.

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40.1. If the liability were to be recovered from Contrella or AA, it would be necessary to show that the relevant company was the "secondary contributor". The secondary contributor is normally the contractual employer (viz the SCI) and it would require some deeming provision to change that analysis. For the reasons already given, the Intermediaries Regulations are unlikely to apply so as to deem either company (or the Agency) to be the "intermediary".

40.2. In order for SSAA 1992 s121C to permit a recovery of this additional NIC from persons involved with the SCI, it would be necessary to show that the person is an officer of the SCI and the failure to pay the NIC is attributable to the fraud or neglect of the relevant officer. An officer as being a "...*a director, manager, secretary or other similar officer of the body corporate or any person purporting to act as such*"[6].

40.3. HMRC will regard the chances of recovery against a director resident in the Philippines as being remote

This is the most alarming sentence in the opinion. The obvious inference is that the purpose of appointing Philippine directors is to stymie HMRC's attempt to recover the tax that is due. That is not a proper purpose for an element to a transaction.

Also note the unexamined consequence: that the Philippine individuals, who we must assume receive no legal/tax advice, are being put in a position where they may have liability to HMRC, which the parties do not intend to cover.

and so will seek to establish that another person is an "officer" of the SCI. It will be difficult for HMRC to contend that Contrella or any individual acting in the capacity of a director or employee of Contrella, is acting as an officer within the above definition. Contrella's dealings with the SCI's will be as counter-party to a contract for the supply of services. It will not (and should not) be purporting to do any action which binds the SCI.

40.4. There are more substantial grounds for contending that AA or one or more of the directors or employees of that company are acting as an "officer" in its expanded definition. AA will be entering in some contracts as an agent on behalf of SCI and dealing with the monies due and from the SCI. It might, therefore, be characterised as being a "manager" of

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the SCI. There is a reasonable counter argument that AA (and its officer and employees) will be expressly acting as a third party agent for the SCI under a limited contractual authority and not acting or purporting to act as any form of officer on behalf of the SCI. However, there is a risk that AA would be regarded as an "officer" particularly if it acted in excess of its contractual authority and/or the director of the SCI effectively abdicated responsibility for directing the company's affairs.

Which is exactly what happened. We have little doubt that whoever was "pulling the strings" of the MUCs became a shadow director, and we expect that they were ultimately acting on behalf of AA. Mr Goodfellow should have appreciated that it was inevitable that Philippine individuals, recruited en masse, would not really have "responsibility for directing [their] company's affairs"

To limit its exposure (and that of its officers and employees), AA should take care to hold itself to third parties only as a contractual agent of SCI and make sure that the director shareholder has enough information to decide upon particular transactions and review its performance as agent. The written communications should be framed in the terms of advice to the director, rather than instructions and the director should be encouraged to participate in as many decisions as possible. In addition, the officers and staff of AA dealing with the affairs of the SCIs should be regularly rotated.

Framing the communications as "advice" does not change the substance of the matter – the transaction would only work if the MUCs acted as directed. So, as noted above, realistically this was always going to be a façade.

40.5. A more robust defence for AA and its officers is that any failure to pay is not attributable to any neglect by AA or its officers. Provided AA and its officers act accordance with the professional advice given to it from time to time and provide accurate information to its advisers as to how it proposes to act, it is likely a tribunal will find that it has exercised reasonable care in seeking to comply with its NIC obligations in this respect. Consequently, AA and its officers should not be susceptible to a personal

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liability notice but I would emphasise the importance of implementing in practice the processes outlined in this Opinion and my Instructions.

This demonstrates why these opinions are so problematic. The opinion is, in our view, clearly incorrect on its face. But, right or wrong, its existence creates a defence for the people behind the structure

Recovery of VAT payable by the SCIs from Third Parties

41. The position is stronger in relation to VAT because a penalty can be recovered from a managing officer of a corporate taxable person where the taxable person is liable to a penalty under FA 2003 s25[7] (i.e. where the company has engaged in conduct for the purposes of evading liability to VAT and that conduct involves dishonesty by the company) and the conduct giving rise to the penalty is, in whole or in part, attributable to the dishonesty of a director or managing officer of the taxable person. So, in practice, it would be necessary for HMRC to show that the director or managing officer had no honest belief that the company was entitled to apply the FRV scheme. Again, so long as the relevant persons have tried to supply accurate information to their professional advisers as to how they operate and have tried to act in accordance with the professional advisers' advice concerning their eligibility to operate the FRV scheme, then, in my opinion, it is highly unlikely that they will found guilty of conduct constituting dishonesty or that the company sought to evade, rather than avoid, VAT.

Another red flag. It appears Mr Goodfellow is being asked about criminal liability for the people behind the structure. This is, once more, something we have never seen in an opinion on a commercial structure. And, again, it is the opinion itself that creates the criminal defence.

42. For similar reasons to those set out in relation to s121C, there are equivalent risks that Contrella (and its officers and employees) and AA (and its officers and employees) will be found to be "managing officers" in relation to the SCIs. The risks are small in relation to Contrella and appreciable in relation to AA. But the real defence should be that that

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there was no dishonest conduct by anyone in adopting and implementing this

In the event it looks like the director of Contrella did suffer serious legal consequences. We do not know exactly how, and whether it related to the matters covered in this opinion or something else.

Transfer of Debt Regulations

43. I do not consider that the transfer of debt provisions in ITEPA 2003 s688A and s688B will apply in relation to Contrella for the following reasons:
   43.1. The SCIs are not "managed service companies" because all the payments they make to their Workers are taxable as employment income and earnings_ s61B(1)(c).
   43.2. Contrella is not a MSC provider because its business will be the supply of labour rather than promoting or facilitating the use of companies to provide the services of individuals_ s61B(1)(d).
   43.3. Neither Contrella nor the SCI will be allowing the Workers to deduct travel expenses under ss337-339 in circumstances where s339A could apply.

44. The position under s688A is more borderline in relation to AA because, subject to s61B(3) exception, it may well be carrying on business as a MSC promoter. However, it may still rely upon the defence that the SPI is not a MSC. Section 688B should not apply because travel expenses are not being claimed.

Application of DOTAS Procedures

45. I am asked whether Contrella or AA could be regarded as a promoter in relation to these arrangements. The definition for NIC purposes is contained in NIC(Application of Part 7 of the FA 2004) Regulations 2012 SI 2012/1868 Regulation 7. In my opinion, it is unlikely that Contrella will be a promoter because it is not carrying a "relevant business" because it is not carrying on a trade profession or business which involves the provision to other persons of services relating to NIC. It is simply a provider of labour and responsible for operating and discharging its own liabilities in relation to NIC.

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46. AA could be carrying on a relevant business because, I infer, that part of its business consists of giving advice to third parties like Contrella and the SCIs concerning NIC. I do not know whether it has been responsible for the design of the arrangements or whether the idea has been generated and worked up by third party advisers. However, it may well be to some extent responsible for the management of the arrangement, thus making it a promoter.

This opinion is dated 11 April 2016.

In early May 2016, Aspire wrote to another client (i.e. not Contrella) telling them it had just sent a instructions for Mr Goodfellow to advise on their (very similar) structure. Aspire said they had "presented Counsel with similar type arrangements in the last few months". It seems clear Aspire designed and promoted the arrangement.

Was Mr Goodfellow really unaware of that?

47. On the factual premise that if Contrella were not able to sub-contract the business to an SCI eligible for the EA and the business would go elsewhere, then, it seems to me that the sole or main benefit of the arrangement from its perspective to obtain the margin it makes on the assignments it is able to sub-contract. Equally, from the SCI's perspective, the sole or main benefit of the arrangement is to obtain the sub-contracted assignment and make the profit on it. If it were not able to obtain the sub-contract, the business would go elsewhere and it would not have the occasion to pay the Worker remuneration which would attract the liability to the secondary NIC. From AA's perspective, the main benefit of the arrangement is to secure additional work. So, in these circumstances, the arrangements would not be "notifiable contributions arrangements" within the meaning of SSAA 1992 s132A(3).

Mr Goodfellow's answer to the DOTAS "main benefit" test is the same as his answer to the "main purpose" tests. That, without the tax benefit, the structure and companies would not exist. This again, cannot be right, because it implies that an arrangement involving SPVs can never have a tax main benefit. It cites no

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caselaw – and, if it had, it would in our view have been clear that the approach was indefensible.

We believe any court would say, without much difficulty, that tax was one of the main benefits of the structure.

48. If a main benefit of the arrangement was to secure an advantage in relation to NIC, then, in my opinion, there must be a risk that that the arrangements would be notifiable arrangements because they fell within Group 1 of the Description Regulations since a promoter might wish to keep the structuring of the arrangement confidential from HMRC to facilitate its continued use[8]. In this context, I am not aware of how well known the proposed arrangement is to HMRC.

49. So, in relation to AA, in particular, it is important to establish that the arrangement is not a notifiable contribution arrangement.

The MUC documentation would, in practice, have to be standardised. Why did Mr Goodfellow not consider the "standardised tax product" hallmark?

Will HMRC adopt a Case by Case Approach to the SCIs?

50. I think it is unlikely that HMRC will adopt a case by case approach if they decide to challenge the effectiveness of this arrangement. In my opinion, they will raise a series of section 8 decision (if they decided to challenge the entitlement of the SCIs to the EA) and/or make VAT decisions terminating the FRV (if they decide to challenge eligibility to be registered). When these appeals are challenged, they will seek to adopt the Lead Case procedure under Regulation 18 of the Tribunal Procedure (FTT) (Tax Chamber) Rules 2009 SI 2009/273 on the basis that the appeals involve a common or related issue of fact or law. Depending on the grounds put forward by HMRC for challenging the arrangements, the appellants may seek to oppose the use of the Lead Case procedure on the basis that there is no common question of fact (because who exercises control over the SCI is essentially a question of fact). But the likely outcome is that at least some of the relevant issues of fact or law will be decided by means of the Lead Case Procedure. Depending on the

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outcome of the Lead Case appeals, the other appellants may decide to distinguish themselves from the Lead Case appeals.

51. I would be happy to clarify or advise further in relation to any matter raised in this Opinion whether by telephone or otherwise.

GILES GOODFELLOW QC
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11th April 2016

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RE: CONTRELLA LIMITED ("CONTRELLA")

O P I N I O N

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Aspire Business Partnership LLP

This, appearing at the very end, is significant. It seems likely that Aspire were the "Instructing Agent" who put the structure together. Certainly there is a connection between Aspire and Compass Star, which coordinated the directors. We discuss this further in the first part of our report.