Fraud & Asset Tracing Against HMRC

***XL Insurance Company SE v (1) IPORS Underwriting Limited; (2) Paul Alan Corcoran; (3) Cheshire Prestigious Cars Limited And (4) Her Majesty's Revenue and Customs* [2021] EWHC 474 (Comm)**

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Al Capone once said: "*The income tax law is a lot of bunk. The government can't collect legal taxes from illegal money.*" Al Capone, of course, had no intention of paying legal taxes. But what would have happened if he had declared stolen funds as income and paid a proportion as income tax?

Background

In this case, the Second Defendant ("**PC**") was the sole owner/director of the First Defendant ("**IPORS**"), a coverholder company that entered into a number of binding authority agreements with the Claimant insurer ("**XL**").

IPORS was obliged to *inter alia* manage claims and collect premiums from insureds on XL's behalf and hold them on trust in segregated premium accounts for XL, before remitting them to XL. Instead, IPORS/PC allegedly under-declared and misappropriated such funds to the tune of nearly £10 million over the course of several years, making large payments to PC's personal accounts and on luxury expenditure (including Manchester United season tickets and c.£25,000 for a night in Paris).

After multiple injunctions (with which PC/IPORS failed to comply) and non-party disclosure orders in support of XL's proprietary and equitable claims, XL discovered that PC had declared on his tax returns as "income" moneys which XL could show were XL's proprietary funds. XL could also show that PC paid the resulting "tax" using XL's premium trust funds.

XL successfully obtained disclosure of PC's tax records from HMRC (*XL Insurance Company v IPORS Underwriting & Others* [2018] EWHC 2251 (Comm.)) and further information from other disclosure orders thereafter.

Submissions

XL then sought to add HMRC to the proceedings advancing proprietary and unjust enrichment claims in respect to HMRC's receipt of the funds. Essentially, the parallel allegations were that (a) stolen money is not income; and (b) the money HMRC received was not PC's to pay.

HMRC opposed the application on the basis that, even if there was no underlying tax due, HMRC was *a bona fide purchaser for value without notice*. This was on the basis that under s.59B of the Taxes Management Act 1970 (the "**TMA**"), a taxpayer must pay the sum stated on his return, subject only to limited statutory exemptions for the taxpayer to amend the return or reclaim an overpayment, the time limits for which had expired here.

HMRC therefore argued that there was an enforceable statutory debt. In other words, the debt created by the return was self-standing – it did not matter what had gone before. The payment, it submitted, had been used to discharge a valid debt and could not be retrieved.

XL said that this was keyhole vision. It argued *inter alia* that: (a) the TMA applied only as between HMRC and the taxpayer, and did not apply to third parties, not least innocent ones in the context of fraud; (b) the bona fide purchaser for value defence could not be invoked by operation of law and HMRC's position was akin to that of a squatter; (c) the defence should not apply where there was a voluntarily created liability, with PC here manufacturing a liability to effectively conceal his fraud; (d) the Court should look behind the debt to see if real value had been given; and (f) once the Court did that, there was clearly no underlying income tax liability, which arose under s.383 of the Income Tax (Trading and Other Income) Act 2005, and not the TMA, applying the settled tax law principle that liability is distinct from the mechanics of assessment.

There were also novel arguments regarding subrogation (including over subsisting versus extinguished rights subrogation) and whether XL could be subrogated to PC's right to ask HMRC to exercise its discretion to extend the statutory time limits in the TMA, a discretion XL claimed HMRC had to exercise proportionately to not infringe XL's property rights under Article 1 of Protocol 1 of the European Convention on Human Rights.

Decision

After a day's hearing, Mrs Justice Cockerill DBE allowed XL's application to join HMRC to the proceedings, holding *inter alia:*

(a) That it was well arguable that s.59 of the TMA did not create a real and enforceable obligation like any other and, whilst the provisions of the TMA do create a statutory debt, s.59 does not *itself* create a liability. It is concerned with the mechanics of calculating the taxable charge. [33-38]

(b) Where one does not have any underlying liability at all, it "*logically undercuts the structure which is then imposed on it, which structure only exists for the purposes of defining and quantifying that liability*". [41]

(c) The Court found support for the argument that any debt is created between the taxpayer and HMRC, and not third parties, in the provisions of the TMA [54]. The Judge cited XL's example of PC stealing XL's car and leaving it in HMRC's car park and, as payment in kind for tax, HMRC seizing the car. In those premises, XL's claim would have nothing to do with PC's assessment [58].

(d) The Court emphasised the distinction between the taxpayer and a third party in the context of liability arising. [44, 45] Whilst a tightly defined scheme between HMRC and the taxpayer makes perfect sense, the scheme is predicated on the existence of a liability. The Judge held it was not within the contemplation of the drafters of the TMA that a taxpayer might for nefarious purposes declare a liability when there was none, such that this case was operating outside of the paradigm on which the self-assessment regime was predicted.

(e) It was at least arguable, in circumstances where there is no underlying liability, and where the challenge is not by the taxpayer but the beneficial owner of the moneys in question, that the Court may be prepared to unravel this structure by appropriate means. [50] The Judge found support for this in bankruptcy cases where the Court had power to dismiss or stay petitions and go behind judgments in cases of fraud or in other exceptional circumstances. [51-56]

(f) The cases cited by HMRC on the satisfaction of an existing debt constituting good consideration for the purposes of the defence of bona fide purchaser for value were "*highly questionable*" for the broader proposition that they applied to a self-created statutory debt. [66] The Judge considered there was greater force in XL's submission that HMRC's position was not dissimilar to a squatter i.e. the passage of time may confer rights upon the squatter but this does make he or she a "*purchaser for value*" [68] and that HMRC was seeking to retain sums based on fictious figures by operation of law. [71]

(g) The Judge accepted there was a perfectly sound analogy with the cases XL cited on volunteers and found support for the Court looking for the true value being given in return for the creation of a liability. [73-76]

Comment

The case is of obvious significance regarding the approach HMRC should take regarding receipt of stolen funds. However, the case raises a number of broader points of interest beyond the unusual recipient of the funds:

(a) The case confirms the historical thinking that bona fide purchaser for value without notice applies "*by grant rather than by operation of law*" (*Snell's Equity* (34th Edition) at [4-022]).

(b) It is a rare case dealing with the "*for value*" part of the bona fide purchaser for value without notice defence, a defence that applies to both proprietary and unjust enrichment claims. It shows the Court's ability to look behind a debt not only in this context but also in the context of unjust enrichment more generally.

(c) The case also endorses the reasoning in authorities such as the Supreme Court's decision in *Menelaou v Bank of Cyprus* [2016] A.C. If the defence of bona fide purchaser for value without notice is raised, the Court will look at the obligation satisfied in its context and not with keyhole vision. For the purposes of the debt HMRC relied upon, the

Court emphasised seeing the alleged debt as between the parties to it, and not from the perspective of the third party victim of the fraud. That would not, of course, be the case had the debt been an overdraft owed to a bank.

(d) The case may have implications on the interpretation of the self-assessment provisions of the TMA and offer routes to open-up a tax return even if the statutory exemptions and time limits for them are unavailable (at least in regard to third parties).

(e) Finally, there were important principles at stake regarding HMRC's attitude to ill-gotten gains.

i. First, there was a logic to HMRC's submission that the matter should begin and end with the express provisions of the TMA. There are also sound reasons for finality in a taxpayer's self-assessment if the time limits for the express statutory mechanisms for amending it (e.g. 4 years to reclaim an overpayment) have passed. However, once one invokes the unruly hobby horse of policy, it cannot be right that, as between HMRC and an innocent third party victim of fraud, the Court cannot look behind a manufactured debt and that HMRC should retain stolen proprietary funds on which no underlying tax was due. That would arguably be aggravating the fraud. Further, whether something is a debt under the TMA does not mean it satisfies the equitable defence of bona fide purchaser for value.

ii. Second, it is not unknown for defendants seek to "legitimise" money that they know they should not have by acting as if they obtained it properly. It is the sort of "doublethink" of which fraudsters particularly capable (called "acting out" in psychiatry). No doubt it would also help in any defence to a criminal charge.

Case details

Joseph England acted the successful Claimant, instructed by Andrew Hall of XL's in-house legal team (with Laurent Sykes QC of Gray's Inn Tax Chambers providing tax advice). Ajay Ratan of Blackstone Chambers appeared for HMRC.

A copy of the judgment can be found here.

- Court: High Court of Justice, Queen's Bench Division, Commercial Court
- Judge: Mrs Justice Cockerill DBE
- Date of judgment: 4 March 2021

Joseph England

Joe is recognised as Leading Junior in four categories in Legal 500 2021, including for Civil Fraud where is described as: *'An up-and-coming star in civil fraud litigation. He has an intuitive for how the Court will see cases. His grasp of the law and how to put legally complicated points is also excellent. He is a dangerous adversary, constantly looking for weaknesses in his opponent's position and clients love him.*" He also appeared as Junior Counsel in the Supreme Court in the *Menelaou* decision referred to in the judgment.

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