THE HIGH COURT

BANKRUPTCY

No. 2398

IN THE MATTER OF DERMOT O'ROURKE, A DISCHARGED BANKRUPT.

JUDGMENT of Ms. Justice Costello delivered on the 16th day of March, 2018

1. The issue in this case is whether or not surcharge payable by the discharged bankrupt (the taxpayer) on foot of a notice of opinion issued by the Revenue Commissioners pursuant to s. 811 of the Taxes Consolidation Act, 1997 (the TCA) to the effect that a pre adjudication transaction was a tax avoidance transaction is a pre or post adjudication debt or liability which is provable in the taxpayer's bankruptcy pursuant to s. 75 of the Bankruptcy Act, 1988 as amended.

Background

2. In 2006 the taxpayer made capital gains in excess of €121 million on the disposal of his interest in certain property and shares. In December, 2006 he entered into a transaction (the impugned transaction) relating to the acquisition of certain German bonds which reduced the taxpayer's capital gains tax return for the year 2006 by €2,693,799. In 2007 he duly filed a self assessed return for his capital gains tax liability for 2006 claiming a reduction in his liability in respect of the impugned transaction.

3. On the 13th April, 2010 the Revenue Commissioners anti avoidance unit (direct taxes) notified the taxpayer that it would commence an audit of the impugned transaction commencing on the 5th May, 2010 pursuant to s.811 of the Taxes Consolidation Act, 1997 ("TCA"). On the 27th July, 2011 the taxpayer was adjudicated bankrupt. On the 20th December, 2011 a report on the impugned transaction was furnished to the nominated officer for his consideration under provisions of s. 811 of the TCA. On the 21st December, 2011 a notice of opinion pursuant to s. 811 was sent to the taxpayer. The nominated officer formed the opinion that the impugned transaction was a tax avoidance transaction within the meaning of s. 811 and he determined that the tax advantage in the sum of €2,693,799 should be withdrawn from the taxpayer and a surcharge was payable pursuant to s. 811A of the TCA.

4. On the 17th January, 2012 the taxpayer appealed against the determination pursuant to the provisions of s. 811 (7) TCA notwithstanding the fact that he had been adjudicated a bankrupt and that the right to appeal the notice of opinion had vested in the Official Assignee. On the 27th July 2014 the taxpayer was discharged from bankruptcy. On the 4th December, 2015 the Appeal Commissioner rejected the taxpayer's appeal and held that the tax consequences specified in the notice of opinion should stand. On the 11th December, 2015 the taxpayer's solicitors required that the appeal be reheard by a judge of the Circuit Court pursuant to s. 942 TCA. However on 9th May, 2016 the Official Assignee withdrew the taxpayer's appeal against the notice of opinion. Accordingly the Revenue Commissioners wrote to the taxpayer on the 21st July, 2016 notifying him of this fact and advising him that the opinion was now final and conclusive. The letter stated that the capital gains tax due following the withdrawal of the appeal was a pre bankruptcy debt but that:

> *"The surcharge imposed by Section 811A Taxes Consolidation Acts, 1997 on that capital gains tax charge arises when the notices of opinion becomes final and conclusive, that is, when the appeal was withdrawn on 09 May 2016.*
>
> *The surcharge, in the sum of €239,867, is now due and payable and should be paid immediately."*

5. On the 13th February, 2017 a final demand in that amount was raised against the taxpayer. The taxpayer contends that the liability to CGT and to the surcharge levied pursued to s. 811A related to a "tax" event, CGT from 2006, which predated the bankruptcy of the taxpayer. Section 136 of the Bankruptcy Act, 1988 prohibits any creditor's remedy against the property or person of the bankrupt. The liability to pay the surcharge was a debt provable in his bankruptcy by reason of the provisions of s. 75 of the Bankruptcy Act, 1988 and that accordingly he is not liable to pay the surcharge levied by the Revenue Commissioners.

6. The parties could not resolve the issues between them and so the taxpayer issued a motion seeking the following reliefs:

> *"1. An order pursuant to s. 61 (7) of the Bankruptcy Act, 1988 requiring the Official Assignee to exercise his powers pursuant to s. 61 (3) (b) of the Bankruptcy Act, 1988 to compromise the Revenue Commissioners claim to a surcharge pursuant to s. 811 A of the Taxes Consolidation Act, 1997, in the amount of €239,867, it being a pre adjudication debt of Dermot O'Rourke.*
>
> *2. Further or in the alternative, an order pursuant to s. 61 (7) of the Bankruptcy Act, 1988 requiring the Official Assignee to seek the directions of this honourable court pursuant to s. 61 (6) of the Bankruptcy Act, 1988 to determine whether the Revenue Commissioners claim to a surcharge pursuant to s. 811 A of the Taxes Consolidation Act, 1997, in the amount of €239,867, is a pre adjudication debt of Dermot O'Rourke."*

7. In written submissions the taxpayer recast the issue raised by his motion as whether the imposition of a surcharge by the Revenue Commissioners is a provable debt pursuant to s. 75 of the Act and therefore, a provable debt for the purposes of the taxpayer's bankruptcy. The parties approached the motion on this basis in argument before the court.

Section 75 of the Bankruptcy Act, 1988

8. Section 75 provides:

> *"(1) Debts and liabilities, present or future, certain or contingent, by reason of any obligation incurred by the bankrupt or arranging debtor before the date of adjudication or order for protection and claims in the nature of unliquidated damages for which the bankrupt or arranging debtor is liable at that date by reason of a wrong within the meaning of the Civil Liability Act, 1961, shall be provable in the bankruptcy or arrangement…*
>
> *(4) An estimate may be made by the Court of the value of any debt which, by reason of it being subject to any contingency or for any other reason, does not bear a certain value and the amount of the estimate shall be proved as a debt."*

9. All parties were agreed that a debt or liability is provable in a bankruptcy if it arises "by reason of any obligation incurred" by the bankrupt before the date of adjudication. The taxpayer's argument was that the obligation to pay the surcharge pursuant to ss. 811 and 811A of the TCA was incurred in 2007 when the taxpayer filed his capital gains tax return in respect of the year 2006. The

Revenue Commissioners say that the obligation was only incurred when the opinion of the nominated officer became final and conclusive pursuant to the provisions of s. 811 of TCA, which in this case was 21st July, 2016, and accordingly the obligation to pay the surcharge is a post adjudication debt.

The Authorities

10. Initially the Revenue Commissioners relied upon *In The Matter of Sean Barry, a Bankrupt* (unreported, High Court, Fullam J. 3rd March, 2017) as being substantially determinative of the issue in this case. However researches on behalf of the taxpayer revealed that the two decisions of the English Court of Appeal upon which Fullam J. relied (*Glenister v. Rowe* [2000] Ch 76 and R. (*Steele) v. Birmingham City Council* [2006] 1 WLR 2380) had been expressly overruled by the Supreme Court of England and Wales in the case of *In Re Nortel GmbH* [2014] AC 209. On that basis the Revenue Commissioners no longer sought to rely upon the decision in *Barry* and it was accepted that this Court should not follow it, as it had been decided *per incuriam*.

11. In *Nortel* the Supreme Court considered the effect of r. 13.12 of the Insolvency Rules in England and Wales, which are in similar terms to s. 75 of the Act of 1988. Insofar as is relevant, the rule provides:

> *"13.12.—(1) "Debt", in relation to the winding up of a company, means (subject to the next paragraph) any of the following—*
>
> *(a)any debt or liability to which the company is subject at the date on which it goes into liquidation;*
>
> *(b)any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date; …*
>
> *(3) For the purposes of references in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; …" (emphasis added).*

12. The question for consideration was whether a particular statutory liability in issue in that case arose "by reason of any obligation incurred before" the insolvency event.

13. At para. 74 Lord Neuberger of Abbotsbury observed that the word obligation in many contexts has the same meaning as liability but it clearly cannot have the same meaning in the context of r. 13.12 as it must imply a more inchoate or imprecise meaning than liability because the liability is what can be proved for, whereas the obligation is the anterior source of that liability.

14. At para. 77 he held:

> *"I would suggest that, at least normally, in order for a company to have incurred a relevant "obligation" under rule 13.12(1)(b), it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also, I think, relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1) (b)"*

15. Lord Neuberger pointed out that a party to legal proceedings is brought within a system governed by rules of court which carry with them the potential for being rendered legally liable for costs subject to the discretion of the court. It follows that in proceedings commenced before a company went into liquidation any order for costs made against the company is provable as a contingent liability under r. 13.12(1) (b) "*as the liability for those costs will have arisen by reason of the obligation which the company incurred when it became party to the proceedings*."

16. Lord Sumption agreed with this conclusion and held at para. 136:

> *"In the costs cases, I consider that those who engage in litigation whether as claimant or defendant, submit themselves to a statutory scheme which gives rise to a relationship between them governed by rules of court. They are liable under those rules to be made to pay costs contingently on the outcome and on the exercise of the court's discretion. An order for costs made in proceedings which were begun before the judgment debtor went into liquidation is in my view provable as a contingent liability, as indeed it has been held to be the case of arbitration proceedings: in Re Smith; Ex p Edwards (1886) 3 Morr 179. In both cases, the order for costs is made against someone who is subject to a scheme of rules under which that is a contingent outcome. The fact that in one case the submission is contractual while in the other it is not, cannot make any difference under the modern scheme of insolvency law under which all liabilities arising from the state of affairs which obtains at the time when the company went into liquidation are in principle provable. Of course, an order for costs like many other contingencies to which a debt or liability may arise, depends on the exercise of a discretion and may never be made. But that does not make it special. It is not a condition of the right to prove for a debt or liability which is contingent at the date when the company went into liquidation that the contingency should be bound to occur or that its occurrence should be determined by absolute rather than discretionary factors."*

Discussion

17. The crucial question for determination is when was the obligation to pay the surcharge incurred? In order to answer this question, it is important to consider the scheme of self assessment and the powers of the Revenue Commissioners to examine transactions pursuant to s.811 of the TCA. Capital gains tax is paid on the basis of self assessment. The obligation is on the taxpayer to make correct returns. This includes an obligation not to claim reliefs from liability to tax to which the taxpayer is not entitled. A taxpayer is under an obligation not to rely upon a scheme which is a tax avoidance scheme within the meaning of s.811 of the TCA when submitting his or her capital gains tax return. Once a taxpayer relies upon a scheme which reduces his liability to tax, his affairs potentially fall within the scope of s.811 of the TCA. If the scheme is not a tax avoidance scheme within the meaning of s.811 then there will be no liability to pay further tax or surcharge pursuant to s.811A of the TCA. On the other hand, if the scheme is a tax avoidance scheme, it is possible that a nominated officer, within the meaning of the TCA, may investigate the transaction and form an opinion to that effect and that a tax advantage claimed should be withdrawn. It is further possible that an opinion that the scheme is a tax avoidance scheme may become final after the elapse of 30 days or, at the end of any appeals taken by the taxpayer. In this eventuality a liability to further tax and surcharge will arise. Thus, the potential liability to pay the surcharge arises from the nature of any transaction entered into by the taxpayer and his filed tax returns claiming some tax benefit based upon the transaction.

18. The Revenue Commissioners are not entitled to levy a greater amount of tax than that specified in the taxpayer's return. So if no steps are taken, there is no liability or even potential liability to pay additional tax or surcharge. The critical provision in my opinion is s. 811(4) of the TCA 1997. This provides:

> *"Subject to this section, the Revenue Commissioners as respects any transaction may at any time—*
>
> *(a) form the opinion that the transaction is a tax avoidance transaction,*
>
> *(b) calculate the tax advantage which they consider arises, or which but for this section would arise, from the transaction,*
>
> *(c) determine the tax consequences which they consider would arise in respect of the transaction if their opinion were to become final and conclusive in accordance with subsection (5)(e), and*
>
> *(d) calculate the amount of any relief from double taxation which they would propose to give to any person in accordance with subsection (5)(c)."*

19. It is open to the Revenue Commissioners as respects any transaction to investigate the transaction to ascertain whether or not the transaction is in the opinion of the Revenue Commissioners a tax avoidance transaction within the meaning of the section. However, if they never conduct an investigation pursuant to s. 811 then there is no further liability to pay tax on the taxpayer. The critical step is the commencement of an investigation pursuant to s. 811. Once such an investigation is commenced, a contingent outcome is that the Revenue Commissioners may form the opinion that the transaction is a tax avoidance transaction and they may determine that certain tax consequences arise in respect of the transaction if their opinion becomes final and conclusive.

20. If an opinion of a nominated officer under s. 811(5) that a transaction is a tax avoidance transaction becomes final and conclusive and, as a result, an amount of tax is payable by a taxpayer that would not have been payable if the opinion concerned had not been formed, then, pursuant to s. 811(A)(2):

> *"…subject to subs. (3) –*
>
> *(a) the person shall be liable to pay an amount (in this section referred to as the 'surcharge') equal to ten per cent of the amount of that tax and the provision of the Acts, including in particular s. 811(5) and those provisions relating to the collection and recovery of that tax, shall apply to that surcharge, as if it were such tax…"*

21. The combined effect of these two sections is that the Revenue Commissioners are empowered to order an investigation into any transactions. Once they commence an investigation into any transaction one possible result is the formation of an opinion by a nominated officer that the impugned transaction is a tax avoidance transaction within the meaning of s. 811 and that certain tax consequences flow, including the withdrawal of a previously claimed tax benefit. If the opinion becomes final and conclusive this entitles the Revenue Commissioners to recover additional taxes from the taxpayer pursuant to s. 811. This automatically gives rise to the imposition of surcharge liability equal to ten per cent of the amount of the tax to which the taxpayer is liable pursuant to s. 811.

22. It follows that once an investigation is commenced the Revenue Commissioners and the taxpayer are in a relationship the outcome of which is contingent on certain matters occurring. One of these is that the nominated officer may form an opinion that the taxpayer has entered into a tax avoidance transaction and that a tax benefit previously claimed is to be withdrawn resulting in a further liability to tax and to surcharge on the part of the taxpayer.

23. Applying Lord Neuberger's test, the taxpayer in this case had taken or been subjected to some step or combination of steps which had some legal effect and which resulted in him being vulnerable to the specific liability in question such that there was a real prospect of that liability being incurred. The taxpayer had entered into a transaction giving rise to a capital gains tax liability. He also entered into the impugned transaction. He filed a capital gains tax return claiming a reduced liability to capital gains tax by reason of the impugned transaction. He therefore had taken a combination of steps which had the legal effect of declaring his liability to capital gains tax for the year 2006 to be in a certain amount when he was, in the words of Lord Neuberger, vulnerable to the Revenue Commissioners finding that the impugned transaction was in fact a tax avoidance transaction within the meaning of s. 811 if they commenced an investigation under the section. He was then subjected to a combination of steps, the investigation of the impugned transaction leading to a final and conclusive opinion that it was a tax avoidance transaction and that the tax benefit claimed should be withdrawn. These occurred prior to his adjudication as bankrupt. As the actions of the taxpayer and the Revenue Commissioners had left him vulnerable to a liability to tax under s. 811, he was also vulnerable to a liability to a surcharge pursuant to s. 811A on that tax. There was a real prospect of his liability to pay further taxes and a surcharge pursuant to ss. 811 and 811A being incurred. Thus the two requirements identified by Lord Neuberger are satisfied.

24. The liability to pay the surcharge pursuant to s.811A arose after the date of adjudication of the bankrupt but the liability to pay it arose by reason of an obligation incurred before that date. The fact that it is a contingent liability and the contingency in question is remote or might never eventuate does not alter the fact that it is a liability that is provable in the bankruptcy.

25. Lord Neuberger identified a third relevant consideration in determining the issue whether an obligation was a pre-liquidation or bankruptcy liability: whether it would be consistent with the regime under which the liability is imposed to conclude that the step or steps gave rise to an obligation under the relevant insolvency rule.

26. There can be no real debate on this question in this case. The regime under which the liability is imposed in the instant case is the Taxes Consolidation Act, 1997. The Revenue Commissioners accept that the liability to pay the additional tax in respect of capital gains tax for 2006 is a pre-adjudication debt. They accept that this is so notwithstanding the fact that the additional tax was not actually collectible by the Revenue Commissioners until the opinion of the nominated officer pursuant to s.811 became final and conclusive. The liability to pay the surcharge pursuant to s.811A is dependent upon the liability to pay the tax found due pursuant to s.811. The liability to pay the surcharge arises solely by reason of the liability to pay the charge to tax pursuant to s.811.

27. I therefore conclude that it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps which gives rise to the liability to pay tax and surcharge pursuant to ss.811 and 811A each arise by reason of obligations incurred by the bankrupt before the date of adjudication within the meaning of s.75 of the Bankruptcy Act, 1988 and thus are pre-adjudication liabilities provable in the bankruptcy.

28. It follows that the surcharged raised by the Revenue Commissioners is a pre-adjudication debt and is provable in the bankrupcy.

The discharged bankrupt is not liable to pay the surcharge.