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Case No: CO/1375/2017

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT
DIVISIONAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 30/11/2017

Before:

LORD JUSTICE HOLROYDE
&
MR JUSTICE JULIAN KNOWLES

- -

Between:

The Queen on the Application of **1) David Hart** **2) Catherine Pinkney** **3) Benjamin Crampin** **4) Jamie Costello**	**Claimants**
- and -	
1) The Crown Court at Blackfriars **2) The Commissioners for Her Majesty's Revenue and Customs**	**Defendants**

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Rhys Meggy & Patrick Cannon (instructed by **BCL Solicitors LLP**) for the **Claimants**
Andrew Bird (instructed by **HMRC**) for the **Second Defendants**

Hearing dates: 8th, 9th November 2017

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Approved Judgment

Lord Justice Holroyde :

1. This is an application for judicial review of the issue and execution of two search warrants, issued by His Honour Judge Hillen in the Crown Court at Blackfriars on 12th December 2016 and executed by searches of premises on 14th December 2016.

Introduction

2. The first three claimants are founders and designated members, and the fourth claimant is a member, of Optimal Compliance Services LLP ("OCS"), which is described in the claim form as -

> "… a small consultancy which was established to support small and medium size businesses. In particular, OCS supports owner-managed businesses through the creation of modern business structures which promote shared ownership, profit sharing and tax efficiency."

3. OCS publish documents, to which I will refer as briefing notes, in which they indicate the services they offer to clients. They express a belief that all businesses should have "a partnership ethos". They describe a model structure which they have developed, involving both an existing limited company and a new limited liability partnership. Those different entities are referred to as LTD and LLP respectively, and for convenience I shall adopt the same abbreviations in this judgment. Also for convenience, I shall refer to "workers" as a neutral term for persons working in a relevant business, whether as an employee of an LTD or as a Member of an LLP.

4. OCS describe the model in the following terms:

> "The model comprises a bifurcated structure whereby the LLP operates as a captive licensee business and the team members become LLP Members, sharing in operational profits on a part fixed / part variable basis. They retain their employment status with the existing LTD Company but on reduced salaries. As LLP Members they participate in profits and receive monthly drawings."

5. The model involves the setting up of an LLP alongside an existing LTD. Pursuant to a series of agreements, employees of the LTD thereafter receive a reduced salary from the LTD, but become entitled to a share of any profits of the LLP, and are able to draw remuneration from the LLP as advance payments against future profits. The agreements provide for the workers to be paid a substantial sum by way of compensation for the reduction in their earnings from the LTD. They agree to pay these sums to the LLP as their capital contributions to the LLP. These compensation payments and contributions are in the form of book keeping entries as between the LTD and the LLP, and it does not appear that any money changes hands.

6. OCS implemented this model for a significant number of clients, typically small to medium sized LTDs which were facing financial difficulties. From the point of view of the LTD, an attraction of the model was that it achieved an immediate and substantial reduction in monthly payments to Her Majesty's Revenue and Customs

("HMRC"). This was because the salary paid by the LTD to workers who had joined the LLP was on the basis of part-time employment, remunerated at or about the level of the national minimum wage, and therefore PAYE tax and National Insurance contributions were payable by the LTD only in respect of a much-reduced salary. By way of illustration taken from the evidence in the case, an LTD which had previously employed an individual at an annual salary of £57,000 would have been required to make monthly payments to HMRC in excess of £1,950 in relation to the individual's income tax, deducted under the PAYE scheme, and National Insurance contributions. Following implementation of the scheme, the LTD would pay less than £10 per month to HMRC in respect of tax and NI on the reduced salary. The LTD would therefore achieve a benefit in terms of cash flow. The individual, for his part, would have little or no income tax liability in respect of his national minimum wage salary from LTD. He would be liable to pay income tax at a future date, under the self-assessment scheme, on any payment received from the LLP by way of his share of the profits.

7. In one of their briefing notes, OCS referred to a decision of the Supreme Court to the effect that members of an LLP were entitled to work-based pensions, and recommended to their clients or prospective clients that LLP members be treated in the same way as employees for the purposes of work place pensions. The note continued:

> "It is thus becoming increasingly clear that LLP Members are, for all practical purposes, employees as well as being partners. This is particularly important for mortgage (and other loan) purposes. When applying for mortgages and loans LLP Members should always declare themselves as "employees". But for tax purposes partnerships have always been taxed on the basis of partnership profits rather than on payments taken out of the business as partners' drawings. This is similar to the way that people who are "self-employed" are taxed but, of course, LLP Members are not actually "self-employed", as noted above."

8. The implementation of that model came to the attention of HMRC as a result of a voluntary disclosure by accountants acting on behalf of one of OCS's clients. HMRC were concerned that arrangements made in implementation of the model constituted tax evasion rather than a tax avoidance scheme. They began a civil investigation. In July 2016 they began a criminal investigation.

9. In the course of the criminal investigation, a written application for search warrants in relation to the business premises of OCS, and the residential premises of one of the claimants, was prepared by HMRC's officer Mr Russell. He was assisted in drafting the application by Mr Faulkner, a Tax Professional Investigation Officer, and his completed application, dated 9th December 2012, was authorised by a senior officer. The application was made under Section 9 of, and Schedule 1 to, the Police and Criminal Evidence Act 1984, relying on the first set of access conditions. It was Mr Russell who presented the application and gave evidence to His Honour Judge Hillen at the hearing on 12th December 2016.

10. In summary, the claimants contend that in making their written and oral application, HMRC misrepresented both the law and the facts in important respects; made

allegations of criminal conduct when, on a correct interpretation of the law, no crime could have been committed by OCS; alleged an intention on the part of OCS that LLPs adopting the model would never make a profit, when HMRC knew that a number of OCS's clients had in fact declared profits; and alleged a lack of cooperation by OCS, when they knew that in fact the claimants were cooperating fully and no search warrants were necessary. As a result of all or any of those deficiencies, the claimants contend that the learned judge was deprived of the opportunity to make a full and fair assessment of the propriety of issuing the warrants.

11. Before describing the facts in a little more detail, it is convenient to set out the relevant legislative framework and to mention some of the case law which I have considered.

The legislative framework

12. Section 9(1) of the Police and Criminal Evidence Act 1984 provides –

> "A constable may obtain access to excluded material or special procedure material for the purposes of a criminal investigation by making an application under Schedule 1 below and in accordance with that Schedule."

It is common ground between the parties that HMRC were entitled to make an application under section 9, and it is therefore not necessary, in the circumstances of this case, to consider the detailed definition of "special procedure material" contained in section 14 of the Act.

13. Schedule 1 to the 1984 Act makes provision for a Circuit Judge to issue three types of order in respect of special procedure material: a production order or access order pursuant to paragraph 4 of the Schedule; or a search warrant pursuant to paragraph 12. Paragraph 4 requires notice of an application to be given to the person who holds the relevant material, but paragraph 12 does not require notice to the person whose premises are to be searched. Paragraphs 2 and 3 set out two sets of access conditions. By paragraph 1, a production order or access order may only be issued if the judge is satisfied that either the first set or the second set of access conditions is fulfilled. By paragraph 12, a search warrant may only be issued if the judge is satisfied, not only that either the first set or the second set of access conditions is fulfilled, but also that one of the further conditions set out in paragraph 14 is fulfilled.

14. So far as is material for present purposes, paragraph 2 provides as follows:

> "The first set of access conditions is fulfilled if –
>
> a) there are reasonable grounds for believing –
>
> i) that an indictable offence has been committed;
>
> ii) that there is material which consists of special procedure material or includes special procedure material and does not also include excluded material on premises specified in the application…;

iii) that the material is likely to be of substantial value (whether by itself or together with other material) to the investigation in connection with which the application is made; and

iv) the material is likely to be relevant evidence;

b) other methods of obtaining the material –

i) have been tried without success; or

ii) have not been tried because it appeared that they were bound to fail; and

c) it is in the public interest, having regard –

i) to the benefit likely to accrue to the investigation if the material is obtained; and

ii) to the circumstances under which the person in possession of the material holds it, -

that the material should be produced or that access to it should be given."

15. The further conditions, at least one of which must be fulfilled before a search warrant may be issued, are stated as follows in paragraph 14 of the Schedule:

"a) that it is not practicable to communicate with any person entitled to grant entry to the premises;

b) that it is practicable to communicate with a person entitled to grant entry to the premises but it is not practicable to communicate with any person entitled to grant access to the material;

c) that the material contains information which –

i) is subject to a restriction or obligation such as is mentioned in section 11(2)(b) above; and

ii) is likely to be disclosed in breach of it if a warrant is not issued;

d) that service of notice of an application for an order under paragraph 4 above may seriously prejudice the investigation."

In the present case, HMRC relied on the first set of access conditions and on the further condition identified in paragraph 14(d).

16. The meaning, in paragraph 2(b)(ii), of the words "because it appeared that they were bound to fail" was considered by Divisional Courts in *R (S,F and L) v Chief Constable of British Transport Police* [2013] EWHC 2189 (Admin), [2014] 1WLR 1647, and in *R (Newcastle United Football Club Limited and others) v HMRC* [2017]

EWHC 2402 (Admin), [2017] 4 WLR 187. Those cases establish that the subparagraph refers to the belief of the officer making the application at the time of the application. Accordingly, where an application for the issue of a warrant is made in reliance on paragraph 2(b)(ii), the investigating officer must, at the time of the application, believe that other less intrusive methods "were bound to fail", and the Circuit Judge to whom the application is made must consider whether the officer did so believe. Paragraph 14(d), however, requires that the judge must be satisfied that an application for a less intrusive method of obtaining the material sought "may seriously prejudice the investigation". That requirement of judicial satisfaction provides an additional protection for an owner of premises against whom the intrusive measure of a search warrant is sought.

17. At paragraph 93 of the judgment of the court in *Newcastle United FC Ltd*, Beatson LJ and Whipple J said:

> "In considering whether the requirements of paragraph 2 have been met, the investigator is obviously not in a position to know for certain what the outcome of any request for voluntary disclosure of documents might be. Nor, in the context of an application for a warrant under paragraph 12, can the investigator know for sure whether a production or access order under paragraph 4 might have been sufficient to secure the documents. Therefore, paragraph 2 can not, consistently with the purpose of the statute, be read literally: whether a less intrusive measure would, or would not, be "bound to fail" must in the end be a matter of judgment for the investigator based on his or her knowledge of the investigation so far and the evidence available. It must, in our judgement, be understood to mean that the investigator believes on the basis of the evidence that there is no lesser measure available which is likely to be effective in securing the relevant documents. Plainly, the investigator must have cogent grounds for his belief. In the context of an application for a warrant, where no notice will be given in advance of execution, the belief is likely to be based on the investigator's suspicion that the relevant material will be disposed of or hidden if advance warning is given, and for that reason, any lesser measure (which would mean that the target is put on notice of the investigation) would be an ineffective means of pursuing the investigation. But, as is clearly stated in *S, F and L* at [62 to 64] and [95 to 97], a bare assertion of such a belief is insufficient if the basis of that belief is not adequately explained in a focussed application dealing with the actual facts of the case. If the investigator has explained the reasons for so suspecting, in terms that are reasonable and compelling, he or she will have fulfilled the requirement in paragraph 2."

18. It is, of course, well established that when an application is made for a search warrant, the judge to whom the application is made must personally be satisfied that the material before the court is sufficient to show that it is proper to grant the warrant. In

order that the judge has all the information which is necessary for him or her to make an informed, balanced and fair decision, the applicant is under a duty to make full and frank disclosure, and to draw to the attention of the judge any material facts which may be relevant to the judge's decision, including any matters which indicate the issue of a warrant might be inappropriate. These principles are clear from, for example, *R (Rawlinson and Hunter Trustees and others) v Central Criminal Court and Others* [2013] 1WLR 1634 at paragraphs 81 - 83. In relation to the requirement of disclosure, the duty of the applicant was expressed in this way by Hughes LJ (as he then was) in *In re Stanford International Bank Ltd* [2011] Ch 33 at para 191: the applicant must –

> "put on his defence hat and ask himself what, if he was representing the defendant or a party with a relevant interest, he would be saying to the judge."

19. Where application is made for judicial review of the issue of a warrant, on the basis that the disclosure made by the applicant to the judge was inaccurate or insufficient, what test should the High Court apply in deciding whether to quash the warrant? Must it be shown that the inaccuracy and/or non-disclosure would have made a difference to the judge's decision, or is it sufficient that it might have done so? Although there are dicta to the contrary in *Rawlinson and Hunter*, I accept that the law in this regard is as stated by Stanley Burnton LJ in *R (Dulai) v Chelmsford Magistrates' Court* [2013] 1WLR 220 at paragraph 45:

> "The question for the court, in judicial review proceedings, is whether the information that is alleged should have been given to the magistrate might reasonably have led him to refuse to issue the warrant."

That test was adopted in *R (Mills) v The Chief Constable of* Sussex [2015] 1WLR 219, in which Elias LJ considered the point in detail at paragraphs 47 to 64 of his judgment. Elias LJ set out cogent reasons of principle why Stanley Burnton LJ's approach was correct. He therefore applied, to the circumstance of the case before him, the test of whether –

> "… the warrant should be set aside because there was material non-disclosure which may well have led the judge to issue a warrant which, had there been full candour, he would have refused to issue".

Similarly, in *Newcastle United FC Ltd*, the court concluded (at paragraph 75) that although mistakes had been made in the application for a warrant, those mistakes were mere slips which were not material to the application or its treatment by the judge to whom it was made, and so –

> "… the information which it is alleged should have been given to the judge could not be said to have reasonably led him to refuse to issue the warrant".

20. Turning to matters of tax law, the Limited Liability Partnerships Act 2000 created the LLP as a new form of incorporated business entity, a requirement of which (by

section 2(1)(a) of the Act) is that there must be "two or more persons associated for carrying on a lawful business with a view to profit". The general rule is that for income taxation purposes, the members of an LLP are treated as self-employed: see section 863 of the Income Tax (Trading and Other Income) Act 2005, which so far as is material for present purposes provides –

> "(1) For income tax purposes, if a limited liability partnership carries on a trade, profession or business with a view to profit –
>
> a) all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),
>
> b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and
>
> c) the property of the limited liability partnership is treated as held by the members as partnership property."

21. There is however an exception to that general rule. With effect from 6th April 2014 the Finance Act 2014 amended the 2005 Act by inserting sections 863A to 863G, the effect of which is to cause some members of LLP to be treated for tax purposes as if they were employees rather than self-employed. The provisions contained in the new section are complex, but for present purposes they can be summarised, as counsel helpfully did. The effect of section 863A is that a member of an LLP is to be treated, for the purposes of the Income Tax Acts, as being employed by the LLP under a contract of service, instead of being a member of the partnership, and his rights and duties as a member of the LLP are to be treated as rights and duties under that contract of service, if each of the conditions A to C is met in his case. The effect of section 863B is that condition A is met if it is reasonable to expect that at least 80% of his remuneration from the partnership in respect of his performance during the relevant period is "disguised salary". The section contains detailed provisions as to the time at which the question of whether condition A is met falls to be determined, and as to what is the relevant period. Section 863B (3) defines "disguised salary" as follows:

> "An amount within the total amount is "disguised salary" if it –
>
> a) is fixed,
>
> b) is variable, but is varied without reference to the overall amount of the profits or losses of the LLP or,
>
> c) is not, in practice, affected by the overall amount of those profits or losses."

In summary, condition A cannot apply to an individual member if more than 20% of his remuneration is variable by reference to the performance of the LLP as a whole.

22. The effect of section 863C is that condition B is met if the mutual rights and duties of the members of the LLP do not give an individual member "significant influence over the affairs of the partnership".

23. The effect of section 863D is that condition C is met if the individual member's contribution to the LLP is less than 25% of the disguised salary which it is reasonable to expect will be payable to him by the LLP during the relevant tax year. Again, there are detailed provisions as to the time at which this is to be determined. Sections 863E and 863F contain detailed provisions for calculating the amount of his contribution to the LLP. In summary, his contribution is the total amount which he has contributed to the LLP as capital, minus any amount which he has previously drawn out or received back, or is or may be entitled to draw out or receive back at anytime when he is a member of the LLP.

24. Clearly, the question of whether all three of these conditions are met falls to be determined by reference to the precise circumstances of an individual member of an LLP. It may be the case that, within an LLP, one individual member meets all three conditions, and is therefore is treated for income tax purposes as employed by the LLP, whilst another member may not meet all or any of the conditions and will therefore be treated as self-employed.

25. In the present case, the claimants particularly rely on condition C. The model which they implement for their clients involves each member of the LLP making (in the manner summarised at paragraph 5 above) a contribution to the capital of the LLP which is in excess of 25% of any expected disguised salary. Thus the design of the model means that at least one of conditions A – C will not be met. The claimants contend that section 863A is therefore not engaged and that accordingly, all the individual members of an LLP established in accordance with the model fall to be treated as self-employed for income tax purposes.

26. Chapter 3 of Part 6 of the Income Tax (Earning and Pensions) Act 2003 makes provision for the taxation of payments or other benefits received in consideration for, or in consequence of, or otherwise in connection with the termination of a person's employment, or changes in the duties of or earnings from a person's employment. The compensation payments which are part of the claimants' model would, if large enough, be caught by these provisions. However, the effect of section 403(1) of the Act is that the amount of such a payment only counts as the taxable income of the employee or former employee for the relevant year "if and to the extent that it exceeds the £30,000 threshold". It appears from the evidence that none of OCS's clients who adopted this model ever did agree to pay a worker compensation in excess of £30,000.

The facts

27. When the claimants' model came to the attention of HMRC, it gave rise to concerns as to the tax consequences. HMRC investigated the LLP which had made a self-report through its accountants, and a number of other LLPs which HMRC found to be operating the same model. In the course of the investigation HMRC found, amongst other things, that OCS advised clients to operate a "hypothetical" payroll, and to issue "hypothetical" payslips, in order to show what would have been paid to workers if they had continued as employees of the LTD. HMRC received a copy of

implementation guidelines drawn up by OSC which included the following section in relation to the hypothetical payslips:

> "LLP Members should receive their Hypo payslip each month. Clients should pay this net amount as one bank payment (not split). We do not distribute Actual payslips to LLP Members as a matter of course. The Hypo payslips are used for mortgage applications and the like so should not show the words "LLP" or "Hypo" – see suggested naming advice. The Gross pay shown on the payslip must be described as "pay" not "drawings". Note also for mortgage applications it is important to tick the "employed" box and not the "self-employed" box. LLP members are employees for all purposes apart from for tax purposes and in the business sense, where they are "partners". Partner designation should be shown on business cards and email signatures. LLP members should receive the actual P60 by 31 May each year. If people specifically request a Hypo P60, e.g. for a mortgage application, then we will issue one, but not as a matter of course."

The papers placed before this court include copies of hypothetical payslips in relation to a number of workers with some of OSC's clients. A typical example shows the name of the business, but without either LTD or LLP status being shown. The payslip bears the name of the worker, his or her NI number, but also the worker's NI category and tax code, neither of which have any relevance to a self-employed person. It shows a figure for total pay which represents the monthly amount of the worker's gross pay under his or her former employment by the LTD (but is, of course, much larger than the gross pay in respect of the changed hours and rate of pay). It then shows an amount of deductions from that figure in relation to income tax and national insurance (even though the LTD has not paid such an amount to HMRC). It finally sets out a summary of various amounts, including the "NIable pay" and the "employer's NI", neither of which has any relevance to a self-employed person.

28. The papers before the court also include copies of some of the agreements relating to workers at one of OCS's clients which adopted the model. One of the agreements, dated 19th June 2014, shows the worker as having been employed by the LTD since 19th June 2014 (ie, the same day) at an annual salary of £60,000 but agreeing to be employed for 25 hours per week at a salary of £8,208 with compensation of £30,000. Similarly, another, dated 16th June 2014, shows the worker as having been employed by the LTD since 16th June 2014 at an annual salary of £34,000 but now agreeing to be employed for 25 hours per week at a salary of £8,208 with compensation of £30,000.

29. In the course of the investigation, HMRC also found evidence that, at least in some cases, OSC's fees for their services to the LTD were assessed as a percentage of the "savings" achieved by the LTD as a result of not being required to pay PAYE and NI deductions at the same level as previously.

30. In the course of the civil investigation, HMRC served a number of formal enquiry notices on OSC in relation to some of their clients. On 8th February 2016 the first claimant contacted the officer who was at that stage leading the investigation and

suggested that it would be beneficial to arrange a meeting so that he could explain to HMRC how the LLPs operated, and explain the philosophy underpinning the partnership model. That offer was repeated by the first claimant later in February 2016, when he commented on the considerable amount of work which would be required for OSC and its clients in providing further information which had been requested. He expressed concern that HMRC may have been given misleading information, and sought an opportunity to "explain the context and purpose of the business structuring models we use with our clients". A meeting was then arranged, which took place on 7th April 2016 and was attended by the first, second and third claimants and other representatives of OSC and a number of officers of HMRC. The first claimant gave an explanation of the partnership model, saying that "the partnership ethos involves all the people in the business being involved in the decision-making process and sharing in the profits – not a master/slave relationship". He expressed OSC's view that it is "healthy for all people in the business to be involved in management and contribute to decision making". He said that for clients which were already operating under a partnership ethos, it made sense for them –

> "… to use a legal structure that fits that partnership model. This also means they benefit from the robustness of finances that a partnership model allows. Salaries are a cost to a company and are difficult to vary depending on the profitability of the business. PAYE must be paid to HMRC every month even if the business is not profitable and losses can not be offset against this liability. In contrast, in a partnership tax is only paid when a business makes a profit. [The first claimant] advises clients that they should be paying tax, but only when they can afford it. OCS wants to see its clients being successful and paying tax out of profitability, not out of funds they need."

The first claimant was asked whether the charge for OCS's services was a percentage of savings achieved. His reply was differently noted by the two sides present at the meeting, but the first claimant says he explained that OCS preferred to set a fixed monthly retainer, with a regular review, which was sometimes done "on the basis of a proportion of the forecast or actual cash flow benefits association with adopting a partnership model". The first claimant was also asked about the hypothetical payslips, and was asked whether an example payslip could be provided. He said he did not have one with him, but explained what it would show, adding that OCS would explain things to individual workers so that they would understand that what looked like a payslip showing employment income in fact showed their drawings.

31. HMRC's notes of that meeting were sent to the first, second and third claimants by email on 21st April 2016, with an invitation to them to provide any comments or further explanations they wished. The email set out further information sought in relation to some of OCS's clients, and proposed deadlines for the delivery of that information. The email did not specifically reiterate the inquiry made at the meeting as to whether an example of a hypothetical payslip could be provided. Unfortunately, the first claimant became seriously unwell soon after the meeting, and was not in a position to respond until 21st July 2016. It does not appear that either the second or third claimants sent any response in his absence, and no sample of a hypothetical payslip was sent.

32. During the period between the meeting and the first complainant's response, HMRC continued to receive information from LLPs and from workers. On 13th July 2016 the decision was taken to adopt the case for criminal investigation.

33. In his written response of 21st July 2016, the first claimant commented that OCS's clients were typically not profitable at the time when OCS became involved, and that it would take up to five years of OCS working with them before they began to see significant improvements. He pointed out that many of the clients were in severe financial difficulties, typically owing HMRC substantial sums in overdue PAYE and VAT, when they engaged OCS. He continued –

> "The easy option for them would be to "start again" and allow HMRC to pursue a winding up order from which, of course, HMRC typically receive nothing. However, through our efforts these companies can recover, move back to profitability and clear all their debts including the amounts owed to HMRC who then become a net (charge free) beneficiary of our work."

The first claimant went on to refer to the continuing requests which HMRC were delivering to OCS for information about various clients. He said that he could not continue to allow the business disruption and unnecessary costs incurred in dealing with those enquiries without the proper justification, and was therefore taking professional advice.

34. On 11th November 2016 the first claimant sent an email to HMRC referring to the deadlines imposed by HMRC for the provision for further information. He expressed the view that all relevant information had been provided, though he remained willing to provide some further information. He enclosed a copy of a formal complaint and application for case review regarding the conduct of HMRC.

35. A complaints officer of HMRC replied to that formal complaint on 2nd December 2016. She acknowledged, and apologised for, certain specific errors which had been made in some of the requests for information (for example, asking questions in relation to a particular worker about a tax year when he had not been a member of the relevant LLP). Overall, however, the complaints officer found that HMRC had carried out enquiries appropriately, and did not uphold the complaint. She observed that it was apparent that most delays in the enquiry had been a result of information not being provided by OCS or its clients, despite HMRC allowing extra time to comply. She found no evidence that HMRC had deliberately targeted OCS because of "some fundamental distrust or misunderstanding of partnership models or LLPs". She concluded –

> "Looking at the case, I am unable to agree that you have been transparent and answered our queries. It appears to me that you have not submitted information in an open or timely fashion".

<u>The written application for the search warrants</u>

36. The written application for the search warrants began by stating that HMRC were investigating indictable offences of cheating the public revenue, contrary to common law, and fraud by false representation, contrary to section 2 of the Fraud Act 2006. Mr Russell then went on to set out, in some detail, why he believed that the offences under investigation have been committed. He outlined the model designed and implemented by OCS. He explained that, once the workers had transferred to a new LLP, the LTD would only operate PAYE in relation to a level approximate to the national minimum wage, and that each partner in the LLP would be required to pay income tax and national insurance, on a self-assessment basis, on his or her share of the profits of the LLP. In paragraphs 7 and 8, which were the subject of lengthy submissions before this court, Mr Russell said–

> "7) Central to the success of this scheme is the need to convince HMRC that the employees are genuine partners who actively participate in the strategic management of the LLP. Legitimate partners should benefit from the profit and share the burden of the losses of the business. It is also necessary to convince HMRC that the roles carried on by the individuals as employees and as "partners" are sufficiently distinguishable such that the compensation payments received are legitimately non-taxable.
>
> 8) It is believed OC, in their desire to do this, have misrepresented to HMRC the reality of the "partners" roles within the LLPs in order to convince HMRC that their tax treatment is correct."

Mr Russell then summarised responses received to some of HMRC's enquiries, in which a number of workers had indicated in effect that following the transfer their duties had not changed at all and they had played no part in the management of the LLP. He continued –

> "11) These responses demonstrate that OC have falsely represented the scheme to HMRC in order to legitimise the treatment of the employees as "partners" for tax purposes by demonstrating a non-existent difference between the work previously done as an employee of the company, and that which is now undertaken as a "partner" of the LLP.
>
> …
>
> 14) It is believed that these LLP structures lack true substance and the businesses carry on trading exactly as they were prior to the scheme being implemented. The company's customers are not informed of the existence of the LLP.
>
> 15) In reality the role of the new "partners" does not change and they do not participate in the management of the company. The "partners" continue working as if nothing were to have changed. OC advise their clients to make the payment of the national minimum wage from the Limited Company and the

> drawings from the LLP in one single payment. The amount of the LLP drawings is then cross-charged between the limited company back to the LLP, although this is often only represented by a book entry and no physical transfer takes place. There are other charges between the Limited Company and the LLP, though the legitimacy of these fees is questionable.
>
> 16) The LLPs often operate with no bank account and all financial transactions are paid via the Limited Company's bank account. This includes the "partners" pay which is paid in one single sum together with the employee's salary from the Limited Company."

37. Mr Russell then referred to the compensation payable to workers who became members of the LLP. At paragraph 17 he said –

> "In compensation for the agreement reached with the Company to reduce their working hours, the employee receives a lump sum payment known as a Variation and Settlement Agreement (VASA) receipt. OC claim that this receipt is exempt from tax under section 401 Income Tax (Earnings and Pensions) Act 2003 as it represents a genuine payment as compensation for an employee's change in duties or earnings. This compensation payment is capped at £30,000, which is also the limit to which the exemption applies. However HMRC do not agree with this lump sum being exempt from tax as section 401 Income Tax (Earnings and Pensions) Act 2003 is only applicable to instances in which there has been a genuine termination or change to a person's employment duties or pay. Since HMRC believe that this is not the case and the employee's role, hours and salary are in fact the same, section 401 Income Tax (Earnings and Pensions) Act 2003 should not apply."

Mr Russell then referred to the hypothetical payroll and payslip, and illustrated in a table the reduction in the monthly amount payable to HMRC by the LTD. He said that OCS had described the scheme as doing no more than deferring the payment of income tax and national insurance, because the PAYE bill would not be paid by the LTD at monthly intervals, but the individual workers would be paid on a self-assessment basis after the end of the tax year. At paragraph 27, in another passage which was the subject of lengthy submissions, he said of that description –

> "27) However, we suspect that this has been misrepresented to HMRC. There are a number of fees which flow between the Company and the LLP which HMRC suspects are deliberately designed to ensure that the LLP will never make a profit, and therefore the "partners" will not have to pay HMRC any tax or NICs. Grant Thornton LLP, acting for a user and in correspondence with HMRC, explained that "it is highly unlikely that the LLP will ever make a significant profit"."

38. Mr Russell later observed that if the LLP were genuine, there would be no need for a hypothetical payslip. He said that identical letters were received in response to HMRC enquiries, which, together with other information received, suggested that OCS drafted the letters and instructed the individual workers to sign them before OCS forwarded them to HMRC. He said that letters referred to the individual worker being proud to be a partner in the business and asserting that he or she was fully involved in the management of the partnership business. He said that HMRC did not find those letters credible and regarded them as a misrepresentation of the truth. He said that the purpose of the search of the premises was to obtain evidence that OCS and the claimants "have knowingly created, sold and continued to operate a tax evasion scheme that is sold to small and medium sized businesses for the primary purpose of evading PAYE and NIC to a large scale believed to be in excess of nine million pounds". He explained his reasons for believing that material would be found which was likely to be of substantial value to the investigation and likely to be relevant evidence.

39. The application indicated that Mr Russell had not tried to obtain the material in any other way. In answer to a question, printed on the application form, as to what methods he considered trying but rejected as bound to fail he said –

> "During the course of the civil investigation, Optimal Compliance Services LLP have failed to provide an honest and accurate account of their business operations and continue to thwart any attempt by HMRC to gain an accurate understanding of how the tax scheme operates. Therefore, due to Optimal Compliance Services LLP's refusal to cooperate and provide the accurate information previously I believe that a search of premises is now necessary in order for the material sort to be gathered as part of the criminal investigation."

Mr Russell then referred to the first claimant's letter of complaint and said–

> "An enquiry should cause no distress to any individual if there is a Limited Liability Partnership operating in a genuine commercial manner. It would appear that in most cases, a member of Optimal Compliance Services LLP contacts the individual LLPs to instruct them not to respond to HMRC directly and that they will on their behalf. HMRC believes that this is to ensure that OC can send a uniform response detailing a false business structure".

40. In a later section of the notice of application Mr Russell gave the following reasons why the further conditions in Section 14 of the 1984 Act were met:

> "It is not practicable to communicate with any person entitled to grant entry to the premises, as mentioned in the information of this warrant during the civil investigation into Optimal Compliance Services LLP, the business and those operating within it [the claimants] have demonstrated an unwillingness to cooperate with any request or enquiry thus far by Counter Avoidance. Furthermore, there has been direct attempts by OC

> and their employees to intentionally thwart the HMRC's enquiries, this is seen by the correspondence disclosed to HMRC telling "partners" to not contact HMRC or respond to the enquiries. HMRC instead have received fabricated letters in an attempt to misrepresent the true nature of the scheme to HMRC.
>
> Additionally, service of notice of an application for a production order under Paragraph 4 of PACE Schedule 1 may seriously prejudice the investigation. This is due to the fact that should a production order be served on any business accounts of OC this may raise their awareness of HMRC's investigation".

41. Finally, Mr Russell explained why he believed it to be in the public interest, and proportionate, for HMRC to obtain access to the material, saying –

> "I believe the individuals subject to this application are not going to comply with any order to produce material, this has been demonstrated by the attempts of OC to frustrate the civil investigation and not to supply the requested documentation."

The hearing of the application

42. When the application came before the Crown Court on 12th December 2016, Mr Russell confirmed on oath that the contents of the application were true to the best of his knowledge and belief. Once he had done that, the judge – who had read and considered the application notice – gave the following immediate indication of his wish to be told more about one important aspect of it:

> "Judge: The real question I have in this case is in relation to obtaining the material in any other way rather than by way of a search warrant. So the civil investigation says that they have been obstructed or misleading…
>
> Witness: Yes, we believe so.
>
> Judge: …and serving a production order on them would result you believe in destruction of documents or…
>
> Witness: We believe there's a potential for that, yes.
>
> Judge: Yes. But, has consideration been given to other matters or other methods of obtaining the information other than by the draconian step of a search warrant?
>
> Witness: Yes, we did consider a production order but I believe that was not the best route to go down, after our colleagues on the civil side experienced the difficulties that they have. You know, in the warrant it mentions the complaint letter that we received from him. They have proved very difficult to cooperate with. We believe they have submitted documents to us which have been intentionally given to, sort of, misrepresent their business and the whole

> idea behind the scheme. So, yeah, we believe that gaining material in any other way isn't really feasible at this time.
>
> Judge: And, on the civil side in relation to the civil investigation, just run me through that, that they were asked for information. They gave either this misleading information or were obstructive. Was there any other court order sought in respect of the civil investigation?
>
> Witness: Not [that] I know, sir."

After some further enquiries into the manner in which searches would be carried out, the judge gave his ruling issuing the warrants. He accepted the evidence of Mr Russell that it was considered that less draconian methods would lead to "further obstruction, further misrepresentation and destruction of that which is being sought" and concluded that he was satisfied that the use of a production order rather than a search warrant "would seriously prejudice the application". That last word must, I think, be an error, and the judge must have meant to say "investigation".

43. In a statement made for the purpose of these proceedings, Mr Russell accepts that, at the time when the written application was prepared, he was aware that some of the relevant LLPs had declared profits, though he had not at that stage seen any instance in which an LLP had made a profit on which any tax actually fell to be paid. He says that that accorded with what the accountants Grant Thornton had said in respect of the LLP which they had advised. At the time, he said, only a small sample of LLPs had been checked, all of which showed cumulative losses greater than their profits, and he formed his general suspicion as a result. However, since the search warrants had been executed, a fuller analysis had been carried out. This showed that out of 79 LLPs which have been identified, 15 had declared cumulative profits by January 2016. Mr Russell concludes:

> "It is with regret that full analysis of the LLPs and their partners' returns was not conducted in advance of the warrant application, and I sincerely apologise to all parties for having made this assertion of suspicion without having carried out a full analysis of all the LLP returns which would have been available to me from HMRC records".

Mr Faulkner has similarly made a statement apologising for making the suggestion, that the LLPs were designed not to make a profit, without having first checked all the LLP tax returns.

The submissions

44. This court has been assisted by detailed written submissions on behalf of the claimants and HMRC. They were supplemented at some length by oral submissions from Mr Meggy and Mr Cannon on behalf of the claimants, and by oral submissions from Mr Bird on behalf of the HMRC. I am grateful to them all. It is not necessary to set out every one of those submissions in this judgment, but I have considered them all in reaching my conclusion. The arguments on each side can be summarised as follows.

45. The central argument on behalf of the claimants is that, on a proper analysis and application of the law, OCS's model does have the tax consequences which OCS says it does. Those consequences are that, following the transfer of workers to the LLP, the LTD properly makes to HMRC all payments in relation to PAYE income tax and NI contributions which are due on the reduced salaries of the workers; and individual workers are liable to be taxed, on a self-assessment basis, on their individual shares of any profits of the LLP. Thus, the claimants contend, HMRC receives or will receive all such payments as they are entitled to receive: there is, accordingly, no loss or risk of loss to HMRC (which Mr Meggy submits is an essential ingredient of both the offences alleged against OSC), and no proper basis for any suspicion of criminality. It is submitted that in applying for the warrants, HMRC misled the judge as to the law and as to the way in which the business model operated. In addition, HMRC misled the court by asserting that the model was deliberately designed to ensure that the LLPs would never make a profit, and that accordingly the workers would not pay any self assessment tax or NI contributions, when HMRC knew that a significant number of the LLPs concerned had filed annual returns in January 2016 which did show a profit. Further, HMRC misled the court – both in the written application, and in Mr Russell's evidence to the judge – by wrongly asserting that the claimants had not been cooperative, and by failing to put before the court any information as to the meeting of 7th April 2016, or as to the correspondence before and after that meeting, or as to the many enquiries that OCS had answered and the volume of information which OCS had obtained from their clients at HMRC's request. In those ways, HMRC misrepresented to the court that search warrants were necessary, and that any less intrusive course of action would be bound to fail.

46. Mr Meggy mounted a detailed argument to the effect that, in paragraph 7 of the written application, HMRC must in reality have been intending to refer to the provisions of Sections 863 to 863G of the Income Tax (Trading and Other Income) Act 2005 but had failed to mention condition C. That was an important failure, it was submitted, because the operation of the model had the effect that condition C would not be met, and accordingly the members of each LLP would properly fall to be taxed as self-employed persons. It was, he contended, an example of HMRC seeking to portray as a sinister indication of deliberate tax evasion what was in truth no more than the correct application of the law and the consequences of a lawful scheme. He submits that the same approach is illustrated by the inaccurate claims in the application that it was necessary for OCS to "convince" HMRC of certain matters, when OCS were under no such burden at all and when, in any event, such questions were ultimately a matter for a First Tier Tribunal and not for HMRC to decide. He made detailed submissions to the effect that the compensation payable under the VASAs is genuine, and that the hypothetical payslips – far from being false documents – were merely intended to demonstrate to the workers that their remuneration as members of an LLP was not less than they would have received had they continued to be employed as previously by the LTD.

47. In similarly brief summary, HMRC submit that there were reasonable grounds for believing that the indictable offences of cheating the public revenue and fraud by misrepresentation had been committed by the claimants. It was not necessary for the judge to determine whether the model scheme itself amounted to criminal conduct: HMRC contend that the claimants had misrepresented the scheme, and had concocted letters for tax payers to send which contained apparent falsehoods, and the judge was

asked to consider whether that conduct on the part of the claimants gave rise to reasonable grounds for believing that they (not the tax payers) were committing offences. HMRC denied that paragraph 7 of the application form was intended to reflect the statutory provisions: the essential point was that the claimants asserted that workers were genuine partners, actively participating in the strategic management of the LLPs, when there was evidence to the contrary. Mr Bird invites the court to consider why, if the workers genuinely wished to become partners in an LLP, it was necessary for them to continue simultaneously to be employees of an LTD engaged in precisely the same business; and why, if the purpose of the hypothetical payslips was to reassure workers that their income as employees/partners was not less than it would have been as employees, was it necessary to show deductions for employer's NI which had not in fact been deducted from their reduced salaries. As to paragraph 27 of the application, HMRC accept that 15 of the 79 LLPs have actually declared profits, albeit that in several of those instances the setting-off of losses made in previous years would have the consequence that no member of the LLP would in fact have to pay any income tax. Mr Bird submits, however, that the error was not material, because although it was an over-generalisation it did not undermine HMRC's case, which would have been equally strong if Mr Russell had told the judge that 15 LLPs had declared profits but 64 had not. As to the allegation of a lack of cooperation on behalf of OCS, HMRC maintain their position: they contend that the claimants were not telling the truth about the reality of the scheme, and their giving of misleading answers to HMRC's enquiries did not constitute true cooperation.

Discussion

48. It is accepted by the claimants that, on the information presented to him, the learned judge was entitled to grant the search warrants. The claimants' case is based, not on any criticism of the judge, but on criticism of HMRC for failing to provide the judge with an accurate and fair statement of all material information so that the judge could make a fair assessment as to whether the criteria for granting the search warrants (and for rejecting less intrusive alternative courses) were made out. Counsel formulated the issues for this court in different ways. It seems to me that the questions that I must consider are these:

1) Was the judge misled as to the applicable law?

2) Were the facts upon which HMRC relied misrepresented to the judge?

3) Were there material facts which should have been, but were not, drawn to the judge's attention?

4) If question 2 and or question 3 are answered in the affirmative, were those deficiencies such that the judge might reasonably have refused to issue the warrants if the correct information had been placed before him?

5) If question 4 is answered in the affirmative, what relief should be granted to the claimants?

49. My conclusions are as follows.

50. As to the first issue, the judge was not in my judgment misled as to the law. The application was not put forward by HMRC on the basis that, as a matter of law, OCS's model could never be an effective and lawful means of avoiding tax, and must inevitably involve criminal evasion of tax. It was put on the basis that, whatever the merits of the model might in principle be, it could only ever be effective if there was a genuine transfer of workers from LTD to LLP and a genuine change in employment. HMRC made clear in the written application that they contended they had reasonable grounds for believing that no such genuine transfer in fact took place, and that in fact the workers carried on doing the same as before. Further, as paragraph 8 of the written application made clear, HMRC's belief was that OCS were misrepresenting the reality of the workers' roles within the LLPs, which did not in fact involve any real participation as a partner. HMRC therefore contended that there were reasonable grounds for believing that the model was not genuine, and did not represent the truth of what was occurring, in that the parties to the various agreements made pursuant to the model did not in reality share a common intention to create the legal relationships which those agreements purported to create. That was a permissible basis on which to make the application. I make clear that I am expressing no concluded view as to the merits in principle of the model, and nothing I say in this judgment should be taken as in any way prejudging issues which may one day have to be determined by a First Tier Tribunal and/or by a criminal court. For that reason it would not be appropriate for me to comment in any detail on the many questions which to my mind are raised by documents such as the hypothetical payslips and the agreements as to compensation. I therefore say no more than that, looking at the position as it was presented to the judge on 12th December 2016, in my judgment there was an ample basis for HMRC to assert, and for the judge to accept, that there were reasonable grounds for believing that one or both of the alleged offences was being committed. Reference to the information gathered by HMRC about hypothetical payslips, the agreements to pay compensation, the drafting by OCS of identical letters in which various workers asserted their pride in being active partners, and the information from a number of workers that in fact they played no such part in the affairs of the relevant LLP, is in my view sufficient to show that there were reasonable grounds for that belief.

51. The claimants' submissions maintained that their scheme did properly achieve its aim, that the correct application of the law did mean that workers would be treated as self-employed in relation to their sharing the profits of the LLP, and that therefore there could be no criminality. But that, with respect, inappropriately focuses on the merits of the model in principle, whereas HMRC's case was based on their beliefs as to the reality of what was in fact happening. To illustrate the point by a hypothetical example, a scheme might be devised which was ostensibly intended to achieve legitimate and favourable taxation consequences for persons engaged in the import of goods from abroad. It might or might not be possible to determine that, on a careful analysis of all relevant provisions of tax law, the scheme in principle could achieve that end and constitute lawful avoidance of tax. But that could not avail the tax payers if in truth there never was any intention of actually importing any goods at all, and the scheme was a sham set up for the purposes of evading tax.

52. It is convenient to consider the second and third issues together. I do not accept the submission that the judge was, or could be, misled by the references in the written application to OCS needing "to convince HMRC" of particular matters. That would

be a mis-statement of the burden of proof in the context of criminal proceedings, and it would omit the role of the First Tier Tribunal in determining disputes; but I am not persuaded that it was a misrepresentation in the context of Mr Russell's summarising why HMRC believed that the reality of the operation of the model was different from that which the claimants represented it to be. It was, in my view, simply an imprecise form of words which Mr Russell used to convey his view that, in the investigation thus far, none of the information and material provided by OCS had weakened HMRC's belief that offences had been committed. In any event, even if the statement were inaccurate, it was not an inaccuracy which could reasonably be said to affect the judge's decision one way or the other.

53. Nor am I persuaded that there was any misrepresentation in Mr Russell's references, in paragraph 17 of the application, to the VASAs. In that paragraph he was again doing no more than expressing his beliefs that there was no genuine change in an individual worker's duties or pay, and that the sham arrangement did not justify a supposed payment of compensation.

54. As to paragraph 27 of the written application, Mr Russell was right to apologise for his extrapolating, from the information provided by accountants in relation to one LLP, to a general assertion that the scheme was set up with an intention that none of the LLPs would make any profit. That assertion should not have been made, and Mr Meggy was, in my view, justified in his submission that there was an element of recklessness in making it. However, had the judge been provided with the more detailed information which is available to this court, HMRC would still have been able to mount a compelling case. They would not have been able to assert a general intention to ensure that no profit was made, but they would have been able to point to the fact that no profit had been made in over 80 percent of the relevant LLPs, and that even those which had declared a profit included a number which were able to set that profit off against losses from previous years.

55. Pausing there, none of the matters which I have mentioned thus far in relation to questions 2 and 3 might reasonably have caused the judge to make a different decision on the application.

56. However, I now come to that part of the application which sought to justify the issuing of search warrants, rather than of a less intrusive order such as a production order. As I have indicated above, the more intrusive type of order can only be made if one of the further conditions in Paragraph 14 of Schedule 1 to the Police and Criminal Evidence Act 1984 is satisfied. Here, HMRC asserted that service of notice of an application for an order under paragraph 4 above may seriously prejudice the investigation. In my judgment, that assertion should not have been made to the judge in the manner it was. I will explain why I have reached that conclusion.

57. I do not accept the claimants' assertion that on any fair view, they had been fully cooperative with the enquiries made by HMRC: HMRC were in my view entitled to believe that, although many questions had been answered, the answers had been misleading and there had been no true cooperation. I see no reason to doubt Mr Russell's statement that he had not tried other means of obtaining the material because he thought they would be bound to fail. The claimants however are on much stronger ground in contending that there was no sufficient basis for thinking that the investigation may be seriously prejudiced if the claimants were put on notice of an

application for a production order. It must be remembered that if a production order were granted and not obeyed, there would be serious sanctions available against the claimants. At its highest, in my view, the conduct of the claimants prior to the application could be said to show a reluctance to be frank and a delay in providing information reasonably required of them. That, however, falls well short of providing a basis to believe that if put on notice of an application for a production order, the claimants might prejudice the investigation by the concealment or destruction of documents or of computer records, or by the improper influencing of others to give, or not to give, particular answers to questions which HMRC might ask them. Those are forms of conduct which would at least potentially amount to a serious criminal offence of doing acts tending and intended to pervert the course of justice in relation to a pending criminal investigation. I think it highly doubtful that HMRC could have been able to justify making such an allegation; but in any event, they certainly could not have done so without putting before the judge a much fuller account than they did of what had been done so far by the claimants to respond to enquiries made of them.

58. Moreover, the references to OCS "thwarting" the investigation over-stated the position, and did so in a way which unfairly conveyed the impression of a deliberate attempt by OCS to prevent HMRC from ever obtaining important material. I do not regard that as merely a semantic point: it as an aspect of an incomplete and unfair picture which was placed before the judge. The judge was, from the outset, rightly concerned to satisfy himself that it was necessary (and not merely convenient and desirable from HMRC's point of view) to issue search warrants. I do not see any reason to think that Mr Russell was deliberately trying to obtain an order to which he knew he was not entitled: from what I have read, I think it more likely that he was over-enthusiastic in presenting HMRC's case, and lacked the experience and/or guidance to be appropriately objective. But be that as it may, it is in my view clear that he should – both in writing and orally – have "put on his defence hat" and recognised that anyone speaking on behalf of OCS would obviously have wanted the judge to be informed of the full history of correspondence between the parties, including that the first claimant had suggested meeting with HMRC early on, and of what happened at the meeting in April 2016. Mr Bird realistically accepted that the correspondence and the meeting should have been referred to by HMRC in explaining why warrants were necessary, but sought to argue that HMRC had nonetheless explained the claimants' case sufficiently to enable the judge to reach a fair decision. I am unable to accept that submission. In my view, the judge was denied information which he undoubtedly needed in order to decide whether warrants, rather than less intrusive orders, were necessary.

59. In short, the contention that there had been such a serious failure of cooperation as to justify a belief that the giving of notice may result in the claimants acting in a way would which prejudice the investigation was without a sufficient foundation, was overstated, and was not accompanied by sufficient disclosure to enable the judge to give fair consideration to it. In those respects, therefore, there was in my judgement a material misrepresentation of the facts, and a material failure to draw relevant matters to the judge's attention.

60. For that reason, I decide the second and third issues in the claimants' favour. I do so only on a narrow basis, having rejected their central submission that there were no reasonable grounds for believing that any offence had been committed.

61. Turning to the fourth issue, it seems to me that if the full and fair picture had been placed before the judge, he might reasonably have refused to issue the warrants. At the outset of the hearing, he made clear his very proper concern to satisfy himself that it was necessary and appropriate to issue search warrants. Had he been told of the full extent to which the claimants had responded to enquiries thus far, and had a more detailed exposition been made of the grounds on which it was contended that there may be prejudice to the investigation if the claimants had any notice of it, he might reasonably have taken a different view of the merits of the application. In particular, he might reasonably have taken the view that HMRC should have applied on notice for a production order.

62. It follows that, on a narrow basis which was far from the central thrust of the claimants' case, I find that the issue of these search warrants was unlawful. What, then, is the appropriate relief? Plainly the warrants must be quashed, and the searches carried out pursuant to them must be declared to have been unlawful. That is the only relief for which any application has been pleaded. On behalf of the claimants, Mr Meggy submits that it is open to this court to go further, and to find that the conduct of HMRC was so culpable that they should additionally be ordered to return not only all original material seized during the searches but also any copies made thereof. Mr Bird submits that HMRC should be entitled to retain the material and copies which they presently hold, pending an application pursuant to section 59 of the Criminal Justice and Police Act 2001. The effect of that section is that a prosecuting authority such as HMRC, which has seized property without lawful power to do so, may apply to a judge of the Crown Court for authority to retain that property. By section 59(7), the judge to whom such an application is made may authorise retention if satisfied that, if the property were returned, it would immediately become appropriate -

> "… to issue, on the application of the person who is in possession of the property at the time of the application under this section, a warrant in pursuance of which, or in the exercise of which, it would be lawful to seize the property."

63. I reject the claimants' submission, for a number of reasons. First, the only pleaded claim is for quashing of the warrants and declaratory relief. Secondly, the claimants' case is that they are willing to cooperate in HMRC's investigation, and I find it difficult to see how the claimants could have resisted a production order if HMRC had limited their application to that less intrusive form of order. Thirdly, Parliament has in section 59 provided for a prosecuting authority to be given an opportunity, in circumstances such as these, for an application to be made and for a judge to exercise a discretion to permit retention. Fourthly, although an order such as Mr Meggy seeks was made in *R (Chatwani and others) v National Crime Agency* [2015] EWHC 1283 (Admin), the misconduct in that case was much more serious than I have found here; and at paragraph 139 of his judgment Hickinbottom J (as he then was) set out the relevant principles and indicated that the appropriate relief will be fact-dependent. Fifthly, even taking the claimants' case at its highest I would not have been persuaded that the alleged misconduct was as serious as the claimants contend; and in the event, I have found in the claimants' favour on a much narrower basis. In my judgment, therefore, HMRC are entitled to have an opportunity to make an application to the court pursuant to Section 59 of the Criminal Justice and Police Act 2001.

64. If my Lord agrees, then I would grant this application for judicial review, and order that the search warrants be quashed and the searches executed pursuant to the warrants be declared unlawful. I would grant no other relief, save for such order as to costs as may be agreed between the parties or found to be appropriate after receiving written submissions from the parties.

Mr Justice Julian Knowles:

65. I agree.

Addendum to judgment by Holroyde LJ and Julian Knowles J:

66. Copies of this judgment were provided in draft to counsel, and they were invited to make written submissions as indicated in paragraph 64 above. On the issue of costs, it is common ground between the parties that the total costs should be assessed on the standard basis if they cannot be agreed. There is however no common ground as to whether the full costs should be awarded to the claimants. The claimants submit that they have been successful in obtaining the relief which they sought and should be awarded the whole of their costs. In the alternative, if any reduction is to be made on the ground that they did not succeed on every point, the court should nonetheless start at 100% of the full costs of the claim and then make only "a modest proportionate reduction". HMRC submit that the claimants only succeeded in one of the five grounds on which they argued their claim, and that the "tax technical" issues on which the claimants did not succeed involved extra costs including the instruction of a second junior counsel. Acknowledging that there are "overheads" in any litigation which would make it inappropriate to award the claimants only 20% of their costs, HMRC argue that it would be reasonable and proportionate for the court to award them 25%.

67. In our judgment, the following considerations are particularly important in determining how the court's discretion as to costs should be exercised in all the circumstances of this case:

    i) The claimants have been successful in obtaining the relief which they sought, in circumstances where it was not possible to reach agreement between the parties that the warrants were unlawfully issued and should be quashed.

    ii) Although the claimants only succeeded on "a narrow basis which was far from the central thrust of" their case, it was nonetheless a basis which was sufficient to justify their obtaining all the relief which they sought; and it was a basis which involved on the part of HMRC a material misrepresentation of the facts, and a material failure to draw relevant matters to the judge's attention.

    iii) However, the costs and length of the hearing were significantly increased by the claimants' inappropriate focus on the merits in principle of their model, which formed the central, but unsuccessful, argument in support of their claim.

68. We conclude that in those circumstances the claimants should be awarded a substantial proportion, but not all, of their costs pf the permission application and of

the claim. In our judgment, the fair and proportionate award is that they should have two-thirds of their costs. We shall order accordingly.