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Discovery Assessments: Where Are We Now?

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What is Discovery Assessment?

- Taxes Management Act 1970, section 29

- Provision allowing HMRC to make an assessment even though the enquiry window has closed

- In SALF409 HMRC say:

"*HMRC has the power to make 'discovery assessments', under TMA70/S29 (1), to prevent a loss of tax.*

TMA70/S29 provides general rules for HMRC assessments to prevent any loss of tax, but the rules limit the right to make a discovery assessment for any period if a self assessment has already been made by the taxpayer for that period.

…

These rules ensure that a taxpayer who has made a full disclosure in the tax return has absolute finality once the time allowed for opening an enquiry has passed. This is the case even if the tax return is subsequently found to be incorrect, unless it was incorrect because of careless or deliberate conduct. In any case where there was incomplete disclosure or careless or deliberate conduct HMRC have the power to remedy any loss of tax."

- Historically taxpayers have had little success in challenging HMRC's right to make a discovery assessment, what constitutes a "discovery" having been interpreted widely

- A number of more recent cases, including *Fisher*, have successfully challenged HMRC's right to make a discovery assessment

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SECTION 29(1) AND (2)

- Taxes Management Act 1970, section 29 – a complicated provision, especially the safeguards for taxpayers!

- Section 29(1):

"*If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment—*

(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or

(b) that an assessment to tax is or has become insufficient, or

(c) that any relief which has been given is or has become excessive,

the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax."

- Section 29(2) – the first safeguard for the taxpayer:

"*Where—*

(a) the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant [year of assessment][2]*, and*

(b) the situation mentioned in subsection (1) above is attributable to an error or mistake in the return as to the basis on which his liability ought to have been computed,

the <u>taxpayer shall not be assessed under that subsection in respect of the year of assessment there mentioned if the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made</u>"

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SECTION 29(3) – (5)

- These subsections provide a further, potentially more extensive, "get out" for the taxpayer

- Section 29(3):

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—

(a) in respect of the year of assessment mentioned in that subsection; and

(b) … in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

- First condition (section 29(4)):

The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf

- Second condition (section 29(5)):

The second condition is that at the time when an officer of the Board—

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or

(b) informed the taxpayer that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above

- Much of the case law, and many taxpayer challenges to discovery assessments are made on the basis of section 29(5)

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SECTION 29(6) – (7)

- Contain relevant information for applying the relief in section 29(5)

- Section 29(6):

For the purposes of subsection (5) above, information is made available to an officer of the Board if—

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer …; or

(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above—

(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or

(ii) are notified in writing by the taxpayer to an officer of the Board.

- Section 29(7):

In subsection (6) above—

(a) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes—

(i) a reference to any return of his under that section for either of the two immediately preceding chargeable periods; and

(ii) where the return is under section 8 and the taxpayer carries on a trade, profession or business in partnership, a reference to any partnership return with respect to the partnership for the relevant year of assessment or either of those periods; and

(b) any reference in paragraphs (b) to (d) to the taxpayer includes a reference to a person acting on his behalf

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RECENT CASE LAW

- Will consider the following cases, in which the Taxpayer won the discovery assessment points:
  - *Fisher v HMRC*
  - *Freeman v HMRC*

- Begin with *Fisher*
  - The Appellants challenged three separate years of assessment: 2005/06 and 2006/07 (in relation to Stephen and Anne Fisher – the "**Later Years**") and 2002/03 (in relation to Peter Fisher – the "**Earlier Year**")

  - For the Later Years it was argued:
    - Both Appellants had filed tax returns for the Later Years, and at the times when those tax returns were submitted, enquiries had been opened into the tax returns for each of the four previous years of assessment
    - In the enquiries for the years 03/04 and 04/05 the notice of enquiry expressly stated that the enquiry into that year's tax return would form part of the ongoing enquiries
    - No notice of enquiry was given for either Taxpayer for either 05/06 or 06/07. Discovery assessments were issued in 2009 for both years and both Taxpayers
    - The Taxpayer argued that HMRC had accepted that it had all of the relevant facts giving rise to the Later Years' assessments by 31 January 2008

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RECENT CASE LAW: *FISHER*

- HMRC argued that the Later Years' assessments could be made because the Taxpayers were negligent

- In response the Taxpayers argued that they had taken the advice of numerous tax advisors and had at the time the returns were submitted engaged in a dispute as to the proper application of the relevant provisions to the facts for a number of years. During that time, the errors which those advisors perceived in HMRC's analysis had been repeatedly pointed out. The Taxpayers could not be regarded as negligent in failing to agree with HMRC's analysis because they have decided to accept the advice of a number of different reputable tax experts

- HMRC were fully aware of all of the circumstances which might be relevant to the opening of an enquiry. Significant information was provided to HMRC in writing which set out all of the relevant circumstances such as was necessary to justify the exercise of the power to make a discovery within section 29(1) so that subsection (6)(d)(ii) was in point (relying on *HMRC v Lansdowne Partners Limited Partnership* [2012] STC 544).

- References to a return include returns for the two chargeable periods preceding the chargeable period in question. In respect of both Later Years this included 04/05, which was under enquiry as part of the ongoing investigation. All of the information provided as part of that investigation was within section 29(6)(c)

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RECENT CASE LAW: *FISHER* THE DECISION ON THE LATER YEARS

- FTT proposed the following approach:

In testing out whether there has been a discovery it seems that the first step is to look for the first point in time at which an HMRC officer has reached a subjective conclusion as to insufficiency. That is then tested for honesty and reasonableness and for proximity to the assessment date. (It is implicit in the observation in Charlton (at [42] of the UT's decision) to the effect that of an out of time officer who passed the file to another would not be successful in refreshing its newness that a conclusion would already have been reached by the first officer.) The question of when ought the officer to have come to the view there was a loss of tax does not arise however at this stage.

- The FTT also took a wide view of the scope of information relevant for section 29(1) (as opposed to section 29(5)):

We also note that in contrast to s29(5) TMA 1970 where there is a prescribed set of information to consider, there is no such prescription for s29(1) TMA 1970. The information that needs to be considered when looking at an officer who is acting honestly and reasonably is, it seems to us, all of the information which was available to the particular officer who made the purported discovery

- The FTT concluded:
  - The hypothetical officer – by the time of the closure of the enquiry windows – would have been aware of s739 being in contention
  - An officer would reasonably infer from the accounts disclosed and other information viewed in the context of the request it was answering that accounts showing SJG's individual profit figures existed for the year ended 2006 and year ended 2007
  - Reconciled *Langham v Veltema* with their decision
  - Held that both Taxpayers succeeded in relation to the Later Years

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RECENT CASE LAW: *FISHER* THE DECISION ON THE EARLIER YEAR

- The Earlier Years were in relation to the third Taxpayer – Peter Fisher

- The assessment for 2002/03 in relation to peter Fisher, was challenged on different grounds

- The discovery assessment against Peter Fisher for the year 2002-03 was issued on 3 August 2009

- TMA, section 34 at the relevant time provided:

(1) Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case, an assessment to income tax or capital gains tax may be made at any time not later than five years after the 31st January next following the year of assessment to which it relates

- The Appellant argued that the Earlier Year assessment was made on out of time because it was outside the six year time limit in TMA, section 34

- HMRC instead relied on TMA, section 36:

An assessment on any person (in this section referred to as "the person in default") for the purpose of making good to the Crown a loss of income tax or capital gains tax attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf may be made at any time not later than 20 years after the 31st January next following the year of assessment to which it relates

- HMRC asserted that the Taxpayer had negligently failed to file a tax return

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RECENT CASE LAW: *FISHER* THE DECISION ON THE EARLIER YEAR

- The situation in relation to whether or not there had been negligence was somewhat bizarre!

- This only arose because of HMRC's approach to the Earlier Year. Initially all the parties thought that a tax return had been filed, and on this basis an enquiry had been opened into that tax return on 10 January 2005.

- HMRC's computer system recorded a tax return as having been filed

- When HMRC requested a copy of the tax return from the Taxpayer's advisors they could not provide a signed copy (believing that while they prepared the tax return, the Taxpayer, rather than his advisors, had filed the return

- The advisors subsequently found what they believed to be the filed version, and HMRC refused to accept this as the version filed. Consequently, HMRC withdrew the enquiry in June 209, replacing it with a discovery assessment

- HMRC asserted that this assessment was not out of time because TMA, section 36 applied to it, due to the negligent conduct of the Taxpayer

- On this point, the Taxpayer argued:
    - The burden of proof in showing negligence is on HMRC – *Johnson v Scott (Inspector of Taxes)* [1978] STC 48
    - burden relates to showing that the *loss of tax* is attributable to the negligence of the tax payer. The absence of a tax return by itself (assuming that to be the case) does bit bring about a loss of tax in circumstances where HMRC are fully aware of what the tax return would have said (a copy was provided) and that the loss of tax complained of would not have been returned (which was the basis on which an enquiry was opened)

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RECENT CASE LAW: *FISHER* THE DECISION ON THE EARLIER YEAR

- On this point, the Taxpayer argued:
  - The burden of proof in showing negligence is on HMRC – *Johnson v Scott (Inspector of Taxes)* [1978] STC 48
  - HMRC must show that the *loss of tax* is attributable to the negligence of the Taxpayer. The absence of a tax return by itself (assuming that to be the case) does not bring about a loss of tax in circumstances where HMRC are fully aware of what the tax return would have said (a copy was provided) and that the loss of tax complained of would not have been returned (which was the basis on which an enquiry was opened)
  - The Taxpayer was not negligent where:
    - HMRC had recorded that a tax return was submitted
    - unsigned copies the tax return had been provided to HMRC in good time; and
    - the return in question was subject to an enquiry, notice of which had been served on the Appellant

- HMRC argued:
  - the failure of Peter Fisher or his advisers to deliver his 2002/3 return, and/or their failure to ascertain that fact in response to specific HMRC enquiries in early 2005, constitute negligent conduct for the purposes of section 36(1) TMA 1970, thus extending the time limit for assessment to 20 years
  - Peter Fisher and/or his advisers ought to have known that he did not deliver his return, and his advisers ought to have ascertained that fact when enquiries were initially made in this regard

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Recent Case Law: *Fisher*
the Decision on the Earlier Year

- The judge concluded:
  - It was more likely that a tax return was submitted, and lost either within HMRC or en route to HMRC than that the Taxpayer ignored his advisor's instructions to file his return
  - There was insufficient evidence to make findings on the robustness of HMRC's systems at the time for logging receipt of return, retention, and filing procedures for returns within HMRC
  - The Tribunal was unable to unable to infer from the fact the return was not subsequently located within HMRC that the Taxpayer did not send it, especially in the face of evidence that HMRC do lose documents
  - No penalties were issued for failure to file returns despite a return having been issued automatically is more consistent with a return having been received than with it not having been received

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Recent Case Law: *Freeman*

- The *Fisher* case shows a number of grounds upon which a discovery assessment can be challenged

- *Freeman* is another example of when a discovery assessment has been successfully challenged

- The issues in *Freeman* were:
  - whether HMRC were time-barred by failing to have opened an enquiry into the Appellant's 2002/03 Return
  - whether HMRC were permitted to raise a discovery assessment because there was doubt as to whether or not section 29(2) and (5) were satisfied

- In brief, the facts were:
  - The Taxpayer swapped shares in a company for loan notes under a reorganisation
  - The exchange was disclosed to HMRC in a white space disclosure on the 97/98 tax return
  - Loan notes were redeemed by the Taxpayer in 98/99 and 99/00, and were included on the relevant tax returns because they were not entitled to taper relief
  - Loan notes subsequently redeemed in 02/03 were entitled to taper relief (provided that they were not, as the Taxpayer believed, QCBs)
  - The 97/98 return was enquired into in 2000, and in the course of the enquiry the Taxpayer's advisors told HMRC that the Taxpayer's view was that these were non-QCBs
  - In response, the inspector in charge of the enquiry said that he agreed that the facts pointed towards the loan notes being non-QCBs
  - The Loan notes were not, in fact, non-QCBs, instead being QCBs not entitled to relief
  - In 2006 HMRC said that they were going to enquire into the 02/03 return under section 29
  - An assessment was issued in 2007

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RECENT CASE LAW: *FREEMAN*

- The Taxpayer argued:
  - The hypothetical officer mentioned in section 29(5) has had the Tax Return made available to him, and on the basis of information in that Tax Return, and of what a reasonable officer could be expected to know, he could reasonably be expected to have been aware of an insufficiency of tax in the Tax Return
  - The officer who made the original assessment and several other key members of the Complex Personal Return Team dealing with the Taxpayer were aware of the tax status of the Loan Notes before the enquiry window closed
  - The only other document needed to form a view on the insufficiency of tax is the document governing the Loan Notes and the relevant wording of the currency provisions therein, but the HMRC had already taken a view on those provisions and they had changed their mind on the technical position. They had simply failed to look at the Tax Return in time
  - The Taxpayer provided the Respondents with a copy of the Loan Notes in 2000 which satisfied s.29(6)(d)(ii). The Loan Note agreement was provided and HMRC knew both of the existence and relevance of that document. The information was provided to persons who might reasonably be expected to be in some way responsible for the Taxpayer's affairs and who were in fact so responsible

- HMRC argued:
  - The hypothetical officer in section 29(5) is not to be regarded as having knowledge of the contents of the Loan Notes instrument attributed to him
  - Without knowing the terms of the document, the hypothetical officer could not have been reasonably expected to be aware of the insufficiency
  - Section 29(6) TMA is exclusive and exhaustive in defining what information is "made available" to the hypothetical Inspector
  - The enclosing of the Loan Notes instrument in the course of the earlier enquiry did not notify HMRC of the insufficiency in respect of 02/03.
  - The Loan Note would have needed to have been provided with the 02/03 tax return to ensure that the Taxpayer was protected from discovery assessment

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RECENT CASE LAW: *FREEMAN*

- In relation to section 29(5) it was held:
  - the term "discovery" means coming to a conclusion or having reason to believe which in turn gives rise to an assessment of tax. In *Langham v Veltema* [2004] ECWA Civ 193, the Court offered the more simplistic meaning of "for any reason, it newly appears that the taxpayer has been undercharged"
  - In *Charlton & Others v HMRC* the FTT introduced the additional requirement of newness which includes a situation where the original Inspector changed his mind, or a new Inspector took a different view.
  - In the same case, the UT confirmed that all that is required "*is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment*" which can be for any reason, including a change of view, change of opinion, or correction of an oversight
  - There are cases which are complex and the standard expected of the hypothetical officer may be different. In particularly complex tax cases, it is possible that the taxpayer may disclose factual information but an officer may not reasonably be expected to be aware of an insufficiency of tax due to the complexity of the relevant law
  - There is no single benchmark of the knowledge and experience the hypothetical officer should be expected to have. The officer therefore cannot be taken to know every fact known to HMRC nor is he expected to carry the entire corpus of knowledge relevant to his job in his head. An officer should know when he has to look things up and where to look, and when he needs to consult colleagues. The officer should be equipped to do the job and to perform the role within HMRC for which he has been appointed. An officer in a specialist unit would inevitably have more specialist knowledge
  - The disclosure on the 02/03 return did make clear to any hypothetical officer that the Loan Notes were acquired in exchange for shares and not subscribed de novo for cash. To that extent the officer should have been on notice that issues relating to CGT taper relief might be relevant
  - The disclosure on the return should be sufficiently complete and comprehensive and this was not the level of disclosure which was made by the Taxpayer

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Recent Case Law: *Freeman*

- In relation to section 29(6)(d)(ii) it was held:
  - enclosing the Loan Notes under cover of a letter in the earlier enquiry satisfied all the requirements of s.29(6)(d)(ii) other than the notification of its relevance to the insufficiency in respect of the particular tax year in question, i.e. 2002/03.
  - There is no time requirement for notification in writing in s.29(6)(d)(ii)
  - Since subsection (d)(ii) has no temporal restriction the Loan Note instrument which was supplied in 2000 would have alerted an officer, without more, that its terms would have affected liability 2002/3 because that was the year in which the final redemption would occur
  - The Judge said:

When the Loan Notes instrument was supplied in 2000, could it be said that an officer would not have been aware of the implications for the year 2002/3? The officer would have been aware if nothing had changed, that there would have been a final occasion of redemption in 2002/3 and that an incorrect disclosure regarding the status of the Loan Notes as QCBs or otherwise, as indicated in the Tax Return for 2002/3, would have resulted in an insufficiency of tax.

In short, if an officer had the Loan Notes instrument, he would have known that, in respect of later years of assessment in which a disposal occurred, if a Tax Return claimed non-QCB status, there would be an insufficiency of tax. The Tax Return taken with the Loan Note instrument would certainly have alerted HMRC as to the insufficiency of tax.