Comment

Views on topical issues

Discovery assessments

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The law and practice on discovery assessments has lost its balance and, along with it, any realistic protection for the taxpayer.

The subject of discovery assessments has got a bit out of hand. In fact, it has become so confused and, frankly, surreal that there is no longer the protection for the taxpayer which was envisaged when the provisions were originally introduced. As so eloquently explained by Park J in *Langham v Veltema* [2004] EWCA Civ 193:

'[Self-assessment] imposed new burdens on taxpayers by requiring them to submit fuller tax returns than had previously been required …. The new burdens were balanced by new protections for taxpayers who conscientiously complied with the system, in particular by new and tighter time limits on the power of the Revenue to make further tax assessments.'

Unfortunately, the system has lost its balance and, along with it, any realistic protection for the taxpayer. The circumstances which represent a discovery by HMRC are now tolerably clear; however, HMRC's powers to raise a discovery assessment have begun to resemble the powers from a fantasy world. I would submit that there is now an urgent need for a review, by the legislature or the judiciary or perhaps by HMRC, so we can regain that essential element of balance, and so that taxpayers (and advisers) can understand what the rules really are.

Discovery definitions?

The meaning of a discovery has been the subject of a number of different formulations. The most recent of these is from the Upper Tribunal in *HMRC v Charlton* [2013] STC 866: 'In our judgment, no new information, or fact or law, is required for there to be a discovery. 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. That can be for any reason, including a change of view, change of opinion or correction of an oversight.'

This would now seem to represent the definitive view; and the tribunal went on to add the following helpful explanation: 'At one point, an officer is not of the view that there is an insufficiency such that an assessment ought to be raised, and at another, he is of that view. That is the only threshold that has to be crossed.'

The wide meaning given to a discovery has gradually led to the conclusion that it means virtually nothing; therefore, in reality, there is no threshold for the officer to cross. In other words, HMRC can raise an assessment whenever it likes. This may sound like an exaggeration but if we look at the case of *Michael Yip v HMRC* [2014] UKFTT 865 (TC), HMRC raised an assessment on Mr Yip because the officer thought it was a good way to recover unpaid tax. There was no suggestion of any insufficiency in an assessment; it was simply a matter of the best tactics for collecting the tax. Furthermore, the tribunal specifically mentioned that another purpose of the assessment was to elicit information that had not previously been forthcoming. On these grounds, the tribunal concluded that the officer had made a discovery.

I would suggest that this goes too far. The meaning of a discovery may be wide, but it must mean something. It cannot be right to say that an assessment can be issued for any reason or for no reason at all – for example, because the officer had no idea whether there was any insufficiency but there was a deadline looming; because tactically an assessment would be a good idea; or perhaps because it was raining.

We seem to have reached the position that if HMRC raises an assessment, it must have decided to do so; and because it has done so, this means that it must have made a discovery. This circular and self-serving argument must obviously be wrong.

I would respectfully suggest that a discovery does mean something – and that the description (and the threshold to be crossed) set out in *Charlton* is correct. I would also suggest that a definitive statement by a higher court, or perhaps by HMRC, would do a great deal to eliminate the uncertainties which presently exist.

Discovery assessments

Where an officer has made a discovery, TMA 1970 s 29(1)(a) authorises him to raise a discovery assessment. However, s 29(5) provides a degree of finality for the taxpayer by preventing HMRC from raising an assessment outside the 12 month enquiry window, unless: '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 insufficiency].'

There are two key elements here:

- the characteristics of the HMRC officer; and
- the information which must be made available to him.

Let us first consider the officer who is the subject of s 29(5). It was established in *HMRC v Lansdowne Partners Ltd Partnership* [2011] EWCA Civ 1578, and confirmed in *Charlton*, that it is not the officer actually dealing with the matter who has to be aware of the insufficiency, but rather a hypothetical tax officer. The officer is assumed to be of reasonable knowledge and understanding, but there is no uniform standard. He is not a typical or average officer, not even an ordinarily competent officer. He is simply someone who is assumed to have such level of knowledge and understanding as would reasonably be expected of an officer, considering the particular information provided by the taxpayer. This will depend upon a range of factors.

With the greatest respect, this test is impossibly subjective. In fact, it is close to being circular, i.e. if the hypothetical officer failed to understand, he could not have a sufficient level of knowledge and understanding.

The second element in s 29(5) relates to the information which has been made available to the officer, so that he may have been reasonably expected to be aware of the insufficiency.

The difficulty here started right at the beginning in *Langham v Veltema*, where the Court of Appeal said:

'It seems to me that the key to the scheme is that the inspector is to be shut out from making a discovery assessment under the section only when the taxpayer or his representatives, in making an honest and accurate return or in responding to a s 9A enquiry, had clearly alerted him to the insufficiency of the assessment.'

This creates a catch-22 position. If the taxpayer believes that his tax return is correct, he obviously has no reason to believe there is any insufficiency and cannot therefore alert the officer to the insufficiency. However, if he knew that his tax return was incorrect, then HMRC would be able to raise an assessment on the ground that he had knowingly submitted an incorrect return.

The courts may have recognised these difficulties, because *Lansdowne Partners* and *Charlton* have watered down this test to diminish the catch-22 elements. However, as explained below, they have also created further impossibilities for the taxpayer.

The information available to the hypothetical officer for the purposes of s 5 is defined by s 29(6), as follows:

- it is contained in the tax return or accompanying documents;
- it is contained in a claim made by the taxpayer;
- it is contained in any document or particulars furnished by the taxpayer to the officer for the purposes of any enquiry into the return; or
- it is information which could reasonably be inferred from the above.

This is not merely an inclusive definition; it is an exhaustive list. The only information which can be considered by the officer in determining whether he was reasonably aware of the insufficiency is that which falls within the above categories.

We are assisted by the decision in *Charlton*, regarding the information capable of being inferred under s 6(d). In the case of a tax scheme within DOTAS, the court accepted that the inclusion of the scheme reference number on the tax return was sufficient for HMRC to infer all the information which had been provided by a third party under the DOTAS rules.

It is odd that the taxpayer can be protected if the relevant information can be inferred, but has no protection if HMRC actually knows all the facts. In *Abdul Omar v HMRC* [2011] UKFTT 722 (TC), there was a contribution by a company to a FURBS. All the relevant information had been provided by the company about the FURBS; however, this could not be taken into account in connection with a discovery assessment on the employee, because it had not been provided by the employee himself. Similarly, in the case of *Alistair Norman v HMRC* [2015] UKFTT 0303 (TC), the existence of forms P14 and P45 must be ignored because these forms, and all other PAYE information, are provided to HMRC by the company and not by the employee himself.

In *Robert Smith v HMRC* [2013] UKFTT 368 (TC), HMRC clearly knew all the facts about a scheme entered into by the taxpayer. It had written a technical memorandum on its effectiveness and had placed a message on a noticeboard for all tax officers, stating that the scheme was to be challenged. HMRC had raised assessments on 51 taxpayers who used the same scheme. The tribunal said that the 'only reason' it did not assess Mr Smith was because the officer was on sick leave at the time the enquiry window expired. Even though HMRC knew a great deal more about this scheme than the taxpayer, the discovery assessment was allowed to stand because the taxpayer had not himself provided the officer with the information.

Interestingly, in *John Agnew v HMRC* [2010] UKFTT 272 (TC), the tribunal confirmed that particulars furnished by the taxpayer included matters orally conveyed by the taxpayer to the officer. That sounds fair enough – except that we are considering not an actual officer, but a hypothetical officer. The tribunal did not explain how the taxpayer was expected to furnish particulars orally to a hypothetical officer.

In *Anthony While v HMRC* [2012] UKFTT 58 (TC), the tribunal said that it was clearly wrong for the taxpayer to send his information to a distant tax office and expect that would satisfy the requirements. Again, this seems misconceived. The taxpayer should be entitled to protection if he sends the relevant information to HMRC; and there is no requirement about the particular office to which he should send the information. However, there is a much bigger difficulty with this reasoning, because it overlooks a fundamental issue. If it is wrong for the taxpayer to send his information to a distant tax office, where should the taxpayer send it so that it is available to the hypothetical tax officer?

It is no good sending it to the actual officer dealing with the matter, because there is no obligation for the hypothetical tax officer to be aware of information provided to the actual officer who is involved with his case. *Charlton* confirmed that the actual knowledge of the inspector dealing with the matter is irrelevant. One has to look at the objective awareness of a hypothetical inspector – not of the actual inspector involved; and it cannot be assumed that the hypothetical inspector knows anything which was furnished by the taxpayer to the real officer.

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Therefore, the taxpayer may have provided absolutely comprehensive information about all the arrangements and HMRC may be aware of every relevant fact and implication, but they are entitled to disregard all this information? What can the taxpayer do? Send the information all over again? Where should it be sent to? The taxpayer cannot send the information to the hypothetical officer because he does not exist; and if he sends it to the real officer, the hypothetical officer is not assumed to know about it or to regard it as having been made available to him.

The combination of these decisions and the truly fantastic world which they create make it impossible for the taxpayer to satisfy the requirements.

It is well established that it is not enough for the taxpayer to provide HMRC with clues, and to claim that it could have found out more by making further enquiries. The officer must have been provided with sufficient information to be able to make a judgment about the existence of the insufficiency. It is therefore interesting to read HMRC's *Statement of Practice* SP1/06, which says that in valuation cases the taxpayer will be protected from a discovery assessment if he states:

- that a valuation has been used;
- by whom it was carried out; and
- that the valuer was independent and suitably qualified.

However, this information does absolutely nothing to alert the officer that the assessment might be insufficient; it merely enables HMRC to make enquiries. It is therefore odd (although welcome) that HMRC's statement of practice should be in direct conflict with the department's approach in real cases.

What should be done?

It is obviously important that the powers of HMRC to raise assessments are not unreasonably restricted. It is equally important that the taxpayer has the finality which was part of the balance of responsibilities inherent in the system of self-assessment. However, the way in which the law has developed is extremely unsatisfactory and creates utter confusion for both the taxpayer and HMRC, which cannot be good for anybody.

Some clarification of the rules is urgently required so that the taxpayer has at least some chance of understanding how he is supposed to meet his tax obligations – which is exactly what the vast majority of taxpayers want to do. ■