The rules of discovery

Management of taxes

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Anton Lane provides a brief overview of recent developments in discovery

Key Points

What is the issue?

It is essential that a discovery must be sufficient to permit an assessment and that assessment needs to be made in a timely manner for a discovery assessment to be valid.

What does it mean to me?

Recent case law demonstrates that not all discovery assessments are valid for differing reasons.

What can I take away?

Advisers should carefully consider whether discovery assessments are valid before simply accepting them.

The necessity to consider

When an assessment is made outside of an enquiry window, it is necessary to consider if there has been a discovery. TMA 1970 s 29 provides the ability for HMRC to raise an assessment where loss of income tax or capital gains tax is discovered. FA 2010 Paragraph 25 includes discovery provisions for corporation tax and IHTA 1984 s 240 contains similar provisions for inheritance tax.

For income tax, CGT and corporation tax: the legislation was overhauled during the introduction of self-assessment with the aim of providing a taxpayer with finality where adequate disclosure is made.

Two important questions

To determine whether there has been a discovery requires the consideration of two questions:

1. Did the officer who raised an assessment, at the time the discovery assessment was issued, have a belief that there was an insufficiency of tax?
2. Was that belief objectively a reasonable one?

Understanding sufficiency

Following the Court of Appeal case, *Langham v Veltema* [2004] STC 544, HMRC published a statement of practice (SP/106) applying to income tax, CGT and corporation tax. The case considered the sufficiency of the information made available to a hypothetical officer for the purposes of the test in TMA 1970s 29(5).

In that case, an employer gave a house to a director who also controlled the employing company. The director's Self Assessment return was prepared on the basis that the property was worth £100,000. The return was processed without the need for correction. HMRC formed the opinion that the company's corporation tax return should reflect the property transfer at £145,000. A discovery assessment was issued.

The Appellant argued that the property was discoverable from his return and HMRC had been aware of the possible deficiency for over 12 months and were out of time. The Court of Appeal found that TMA 1970 s 29(5)did not preclude HMRC from raising a further assessment because the taxpayer/agent had not clearly alerted HMRC to the insufficiency of the assessment. In the circumstances, the Inspector could not 'reasonably be expected' to infer that the assessment was correct based on the information given.

SP/106, which was released after *Veltema* includes examples illustrating the information that should be disclosed in the additional information space for a return to reduce the risk of a discovery assessment in certain situations:

- Who undertook a valuation, whether an independent and qualified professional;
- For exceptional items in accounts, specify details and how they have been allocated to revenue/capital;
- Where an interpretation of law is relied upon (differing to that published by HMRC) that view should be included.

Benchmark for finality seems quite high

The FTT case of *Anthony While* (2012) TC01755 concerned whether a newspaper cutting sent to the enforcement office and notes of a HMRC meeting fell within the meaning of information made available. It further concerned whether the Appellant had provided information to notify HMRC of its relevance to the insufficiency of the assessment. The newspaper cutting was not sent to the officer responsible for the assessment and there was no evidence it was provided by the enforcement office to the officer. The officer was not furnished with the information.

However, the meeting notes were sent by the officer to the agent/Appellant mentioned the receipt of a large sum of money in respect of damages for wrongful dismissal. It was found that a hypothetical officer would be aware of the compensation for wrongful dismissal, and they had not been included in the return. The FTT also found that the hypothetical officer would be aware of the provisions of Taxes Act 1988 s 148. HMRC submitted that the Appellant’s ignorance of s148 cannot be an excuse. The FTT considered *Adojutelegan v Clerk* (2004) SpC 430 and disagreed with HMRC stating that the point was whether the appellant could exercise due care in respect of a matter of which they were ignorant. The Appellant had reasonable grounds for believing that no tax needed to be paid, in the light of the statement by the awarding judge that it was net of all deductions and that KPMG’s schedule of loss did not bring tax into account. The FTT found that the conditions in s 29(4) and (5) had not been satisfied.

Using an agent doesn’t result in an escape from responsibility

A more recent case, *John McFarlane* (2018) TC06512, concerned whether there was a discovery and if the Appellant had acted deliberately. His accountant, Christopher Lunn, was prosecuted and convicted of fraud in December 2015. The tax returns were compared against information seized in a raid on the accountant and the Appellant had been given the opportunity to produce information although had failed to do so. The Appeal was based on the contention that HMRC had not made a discovery of a loss of tax. Furthermore, the methodology behind the calculation of expenses had been examined in the Crown Court and Christopher Lunn Accountants & Co had not been convicted of any of the charges.

The FTT found that the over-claiming of accountancy expenses resulting in a loss of tax was a discovery. The amount claimed was far in excess of the amount invoiced to the Appellant. The FTT also found a discovery in relation to rental income and allowable expenditure. The interest claimed as a deduction was far in excess of that on interest certificates. In relation to other expenses, HMRC had adopted a method to arrive at a deductible amount and the FTT commented it was ‘fair and possibly generous’.

The FTT, not surprisingly, found that there was a discovery. Furthermore, the actions of the Appellant were deliberate. The important point for advisers is that a person doesn’t simply escape being responsible where an agent is appointed.

Furthermore, and demonstrated by a wonderful quote from Walton J in the High Court judgement of *Nicholson v Morris* 51 TC 95 [1977]: ‘ …it is the taxpayer who knows and the taxpayer who is in a position…to provide the right answer, and chapter and verse for the right answer, and it is idle for any taxpayer to say to the Revenue: “Hidden somewhere in your vaults are the right answers: go thou and dig them out of the vaults”. Simply put, it is important to identify why a discovery assessment is inaccurate.

Stale or new

(1) *Gerrard Gordon* (2) *Gary Connell* (3) *Nicola Martino* (4) *Ian Hills* TC06537 concerned HMRC’s raising of discovery assessments under TMA 1970 s 29 in relation to a pension unauthorised payment. Discovery assessments were in respect of transfers made from registered pension schemes to a QROPS in the tax year 2009 /10. It transpired that the QROPS was not a qualifying scheme.

Two Appellants contended that there had not been a discovery within TMA s 29 because HMRC would have learnt about the transfers from the transferring schemes by 31 January 2011 and an assessment was not raised until 31 March 2014. One Appellant relied on) TMA s 29(2) (prevailing practice at that time) preventing HMRC from raising an assessment, or alternatively on one or both of the conditions in TMA s 29(3) (careless or deliberate act or officer ceased to be entitled to enquire) not being met. The FTT found that HMRC’s approach paid insufficient attention to the fact that the burden is on them to make a positive case that the requirements of TMA s 29 are met. HMRC had identified an issue with the QROPS by 2010 and therefore needed to consider why no assessments were issued until March 2014.

Correspondence dated 26 March 2012 provided by HMRC in relation to one Appellant included a statement that the transfer was an unauthorised payment, and HMRC corrected his return on the basis of an obvious error. HMRC explained this further in a letter dated 2 May 2012. That letter stated that HMRC had established that QROPS was not qualifying and that the QROPS status had been revoked, which happened in 2010.

The appeals were allowed on the basis that the assessments were not validly made under TMA s 29.

Undisclosed scheme

In *Jerome Anderson V R & C Commissioners* (2018) the Appellant claimed the discovery assessment had not been validly made because it was not reasonable that the officer believed there was an insufficiency of tax and instead the officer merely suspected there was. The Appellant further contended that the trading losses incurred arose from a commercial trade. The Appellant, a football agent of thirty years, represented around 20 known players. The Appellant was introduced to a soccer academy in South Africa run by a Jersey company. The company had been set up as a training scheme in South Africa to nurture young talent and promote them through European footballing leagues. The Appellant invested £2,943,000 into the company and selected three players. The investment was funded through a loan from a second Jersey company. Repayments were due in March 2009 and June 2010 equal to two nineteenths of the amount borrowed. The Appellant claimed a loss of £3,002,772 in the 2008/09 tax year. The company went into administration in 2011. The investment had been described by five other participants to HMRC as an undisclosed tax avoidance scheme. A discovery assessment was raised on 2 May 2012 disallowing all the losses.

The UT found that on the basis of evidence and applying the subjective test, the officer did believe that there was an insufficiency of tax and that belief went beyond suspicion.

The UT also found that the FTT applied an objective test considering whether the officer’s belief was reasonable. The test being that the belief is one which a reasonable person could form based on the information available to them and acting on that information, could form the belief.

The UT also considered the possibility of a discovery becoming stale and found there was no issue because the discovery assessment was premature as there had not been a discovery by 2 May 2012.

Discovered

Recent cases are a good reminder of the considerations an adviser needs to apply when a discovery assessment is issued. In the coming years as information flows more readily, whether through information powers or exchange agreements, discoveries could become more frequent. Where there is a discovery assessment, ask the following:

- What information was directly available to the officer?
- Was that information sufficient to identify a tax loss?
- Is the officer’s belief objectively a reasonable one?

- Has the officer raised an assessment in a timely manner?