The return of the inspector

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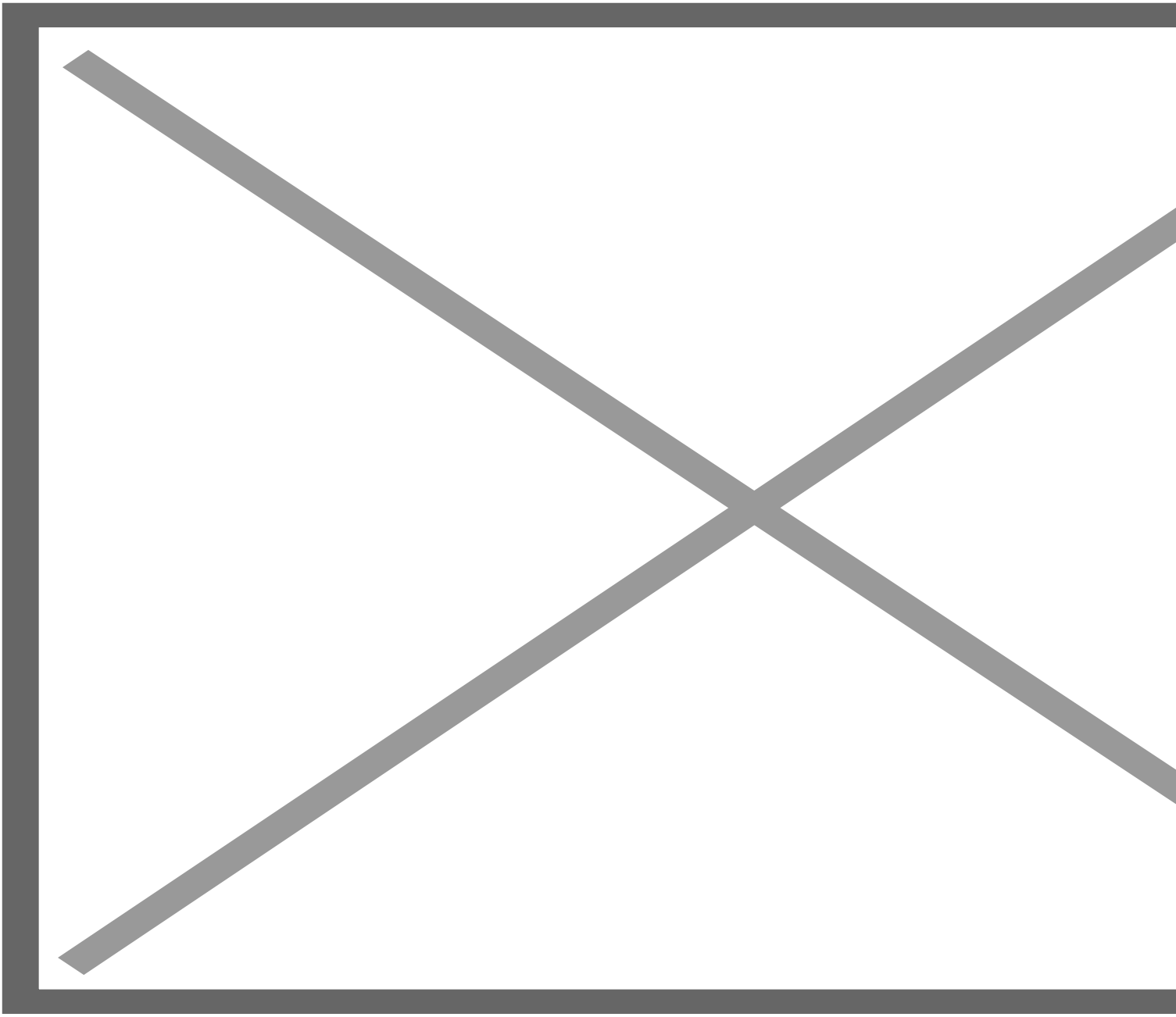

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Keith Gordon looks at the Court of Appeal’s judgment on the legality of an informal HMRC investigation

Key Points

What is the issue?

In most cases, it will be sufficient for taxpayers to consider informal HMRC information requests as if they were made under Schedule 36 and to consider whether or not to comply with them in that light.

What does it mean to me?

At any stage where a taxpayer considers that an information request from HMRC goes too far, the taxpayer should simply decline to provide the information. At that stage, HMRC has a choice: either drop the request or issue a formal Schedule 36 notice.

What can I take away?

It will not be possible to challenge a request taken by HMRC simply because it is based on a flawed understanding of the facts. It will be necessary to go a step further and show that HMRC could not reasonably have thought what it thought.

In the November 2019 issue of Tax Adviser, 'An inspector calls', I discussed the High Court's dismissal of a judicial review claim where the claimant taxpayers sought the Court's supervision over an ongoing (albeit informal) investigation by HMRC into their tax affairs. The taxpayers have since appealed against the decision to the Court of Appeal, which has issued its decision (see [2020] EWCA Civ 784).

The facts of the case

The facts can be simply stated. Since about 2016, HMRC has been investigating the tax affairs of a Mr Bryn Robertson and various corporate entities with which he is associated. Those investigations have included making requests to the tax authorities in Spain and Portugal where much of Mr Robertson's business activities take place. Mr Robertson, however, is UK resident and domiciled.
There are no statutory enquiries into any of the tax returns filed by the UK entities subject to HMRC's investigation (i.e. under the Taxes Management Act 1970 s 9A in Mr Robertson's case or the equivalent provisions for applicable to LLPs and companies). Accordingly, HMRC's information requests have been largely carried out without direct reference to the information powers found in Finance

Act 2008 Schedule 36. As a result, they may therefore be termed as 'informal investigations'.

The High Court rejected Mr Robertson's challenge to HMRC's approach to the investigation. Mr Robertson and a number of these entities appealed against that rejection on three grounds:

- HMRC is not empowered to conduct informal investigations.
- Even if informal investigations are lawful, that power is to be used only in wholly exceptional circumstances.
- On the assumption that the court may intervene only in exceptional cases, this was a case where the court should have intervened to curtail the investigation.

The court's decision

The case came before Lady Justice Simler and Lord Justice Popplewell. They dismissed the appeal.

Power to conduct informal investigations

A number of reasons were given to support the view that HMRC is entitled to conduct informal investigations. Leaving aside the practical advantages (both to HMRC and to taxpayers) of being able to correspond outside the framework of a strict statutory regime, the court noted that the information powers in Schedule 36 were not drafted so as to confer power on HMRC to carry out any form of investigation. Instead, that Schedule is predicated on the basis that such a power exists elsewhere and merely confers on HMRC the right to demand information and documents, etc. (i.e. in the course of such an investigation).

The statutory enquiry provisions (such as TMA 1970 s 9A) contain a prescribed regime for investigations into specific tax returns, with the broad power of investigation being balanced by the strict timetable for commencing such an enquiry and the statutory right of taxpayers to seek a closure notice. However, that is not the only type of investigation that may be carried out by HMRC. (Indeed, Schedule 36 itself makes it clear that information may be sought outside the framework of a statutory enquiry into a tax return.)

As to the statutory source of HMRC's power to conduct informal investigations, the Court of Appeal agreed with the High Court in that this derives from the residual power in the Commissioners for Revenue and Customs Act 2005 s 9, which allows HMRC to do 'anything which they think necessary or expedient in connection with the exercise of their functions, or incidental or conducive to the exercise of their functions'.

Furthermore, as the court added, the question is not what 'is' objectively necessary or expedient or conducive, but what HMRC subjectively thinks is so. In other words, it will not even be possible to challenge an action taken by HMRC simply because it is based on a flawed understanding of the facts. It will be necessary to go a step further and show that HMRC could not reasonably have thought what it thought. Of course, once an error in HMRC's understanding of the facts has been identified, it might be possible to challenge subsequent actions that are taken based on HMRC's earlier (now known to be flawed) views.

Threshold to carry out informal investigations

Although there is established authority to the effect that a wide discretion is given to statutory investigators where criminal or disciplinary proceedings are envisaged, the appellants sought to argue that different considerations apply in the case of purely civil investigations, such as those being carried out by HMRC into the appellants' tax affairs.

However, the court concluded that the same principles that govern the position for criminal and disciplinary investigations should apply to civil investigations carried out by HMRC. In particular, the court accepted HMRC's arguments that statute has determined that HMRC should be the one to decide which investigations are to be carried out (and therefore the courts should be slow to trespass on the process).

This does not mean that the courts should never become engaged. As the court made clear, it is perfectly appropriate to resort to the courts if HMRC is acting unlawfully, is not exercising its powers in good faith or is not acting on a rational basis.

The court should intervene in this case In a similar vein, the court felt that HMRC was not acting inappropriately in this case. The general gist of HMRC's concerns was known and not obviously flawed.

Commentary

As I noted last year, I was not persuaded that the appellants' case was well-founded (at least based on how the facts were summarised in the respective judgments). Indeed, I would tentatively suggest that there is nothing wrong with informal investigations and taxpayers 'voluntarily' providing information to HMRC, which HMRC could legitimately compel under Schedule 36. At any stage where a taxpayer considers that an information

request from HMRC goes too far, the taxpayer should simply decline to provide the information. At that stage, HMRC has a choice: either drop the request or issue a formal Schedule 36 notice, the reasonableness of which can be determined by the First-tier Tribunal.

Nevertheless, to have authoritative statements as to the basis of HMRC's informal investigations is to be welcomed, even more so now that we have the Court of Appeal's views.

I noted above one of the HMRC arguments that the court accepted in relation to the second ground of appeal. However, there were others, which I am slightly less persuaded by or at least in respect of which I would recommend an element of caution. In particular, the court accepted that it was 'desirable' that judicial intervention should take place at the conclusion of the investigation (i.e. in the course of subsequent appeal proceedings) and not any earlier (i.e. at the investigation stage).

Although I accept this as a general proposition, I think one should be careful not to treat it as an immutable rule. In particular, the validity of an information request might itself require the tribunal's adjudication. Indeed, earlier this year, the First-tier Tribunal recognised that it had the power to reach a decision about the appellant's domicile status both in an appeal against a Schedule 36 notice and also when a taxpayer is seeking a closure notice (even though such a question is more usually the subject of a substantive appeal following a closure notice or discovery assessment) (Henkes v HMRC [2020] UKFTT 159 (TC)).

It should be noted that HMRC is probably not happy with the tribunal's decision in that case. However, as the domicile decision went against the taxpayer, it is unlikely to appeal against it.

What to do next

In most cases, it will be sufficient for taxpayers to consider informal HMRC information requests as if they were made under Schedule 36 and to consider whether or not to comply with them in that light. If a dispute arises in relation to any particular request, the request can be formalised and the matter can then be adjudicated by the tribunal.

However, there will be exceptional cases when HMRC does not issue a formal notice but simply gives the impression of 'sitting it out' – neither advancing the investigation nor telling the taxpayer that the case has been formally discontinued. In such cases, it would probably be appropriate to ask HMRC for a clear statement as to the status of its ongoing investigations and, if that answer is unsatisfactory or not forthcoming, to consider judicially reviewing that answer (or lack of it). Nevertheless, I emphasise that this is likely to be a response of last resort for the exceptional case.