Tooth and consequences

Management of taxes | Personal tax

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Keith Gordon reviews the Supreme Court's long- awaited decision in the case of HMRC v Tooth

Key Points

What is the issue?

The Supreme Court's decision was HMRC's fourth successive defeat in its attempts to defend a £475,000 tax bill imposed on Mr Tooth.

What does it mean for me?

The law is now clear: do not drill down into a document to find isolated errors; entries have to be read in their proper context. There is also no concept of 'staleness' in relation to discovery; time limits alone impact HMRC's ability to make a discovery assessment.

What can I take away?

HMRC must act rationally, must not abuse its powers and may be required to respect any legitimate expectation which they have created. If they fail to do so, the taxpayer may seek relief in judicial review proceedings. Such matters are to be

referred to legal experts extremely promptly.

I have already covered the Tooth case, twice before – the Upper Tribunal's decision was discussed in my article 'The honest Tooth' in the May 2018 issue of Tax Adviser and the Court of Appeal's decision in my article 'Jaws 2' in August 2019.

The Court of Appeal's decision was HMRC's third successive defeat in its attempts to defend a £475,000 tax bill imposed on Mr Tooth. Nevertheless, the run of three adverse decisions did not prevent HMRC having a fourth attempt earlier this year. To be fair, in the Court of Appeal, the majority concluded that Mr Tooth had made a deliberate inaccuracy in his 2007/08 tax return so as to validate HMRC's discovery assessment made after 5 April 2014 (i.e. more than six years after the end of the relevant tax year). However, HMRC fell foul of the principle that a discovery assessment must be made whilst the underlying discovery is still fresh – in Mr Tooth's case, the relevant discovery had been considered to have been made many years earlier and was therefore deemed to have gone stale before the assessment was finally made.

The Court of Appeal's decision on deliberate inaccuracy raised many eyebrows, and HMRC has long disputed the concept of staleness. The Supreme Court's decision, published in mid-May (Tooth [2021] UKSC 17), was keenly awaited.

The facts of the case

In early 2009, Mr Tooth had taken part in an avoidance scheme which (he thought) enti tled him to accelerate tax relief through the carry-back rules, so that the relief would be applied to his 2007/08 Self Assessment tax calculation. As the pro forma 2008 tax return did not allow for such a claim to be accelerated in this way, Mr Tooth deliberately used a wrong box on the tax return to achieve his desired purpose, albeit with a white space disclosure explaining what he had done.

HMRC quickly recognised the fact that Mr Tooth's 2008 return did not comply with its views of the law and promptly opened an enquiry. However, rather than enquiring into the return under the Taxes Management Act 1970 s 9A, it considered that the carry-back claim had been made outside the tax return (albeit on the tax return form). As subsequently confirmed by the Supreme Court in the case of Cotter [2013] UKSC 69 (which involved the same avoidance scheme), such carry-back claims

should ordinarily be enquired into using the provisions in Taxes Management Act 1970 Sch 1A and this is what HMRC did in August 2009.

However, Cotter itself made clear that Sch 1A was not to be used in every case – it depended on the precise facts of the case. Cotter has proved to be an exception and it appears that most taxpayers (including Mr Tooth) had put themselves in a situation whereby the correct approach was in fact to use the s 9A provisions. (This was because these taxpayers had taken the additional step to give effect to the tax relief they were claiming by reducing the amount of their self-assessed tax liability. Since a taxpayer's self-assessment forms a part of their tax return, any HMRC challenge must be via s 9A.)

Accordingly, in relation to these taxpayers (including Mr Tooth) HMRC made a series of 'discoveries' in or around 2014 that it had embarked upon its enquiries on the wrong statutory basis. To remedy this, it issued a number of discovery assessments to capture the tax that it ought to have pursued via s 9A.

Because of the timing of these assessments (more than six years after the tax year to which the assessments related), HMRC needed to prove more than merely that the tax was due. It needed to show that the original under-assessment in the return had been brought about deliberately, either by Mr Tooth or by a person acting on his behalf.

The staleness argument related to the fact that HMRC had previously taken the view that Mr Tooth's return was incorrect and that insufficient tax had been paid – this view was apparent when it opened the flawed Sch 1A enquiries. Accordingly, the discovery assessments made over four years later were based on discoveries that, in the meantime, had long gone stale.

The Supreme Court's decision

The case came before Lords Briggs, Sales, Reed, Leggatt and Burrows. The judgment was written jointly by Lords Briggs and Sales, and endorsed by the remaining members of the panel. Its opening paragraph sets out clearly and succinctly the context in which discovery assessments are made, how they fit in with the enquiry process and the main time limits that govern the making of discovery assessments.

On the question of a deliberate inaccuracy, the Supreme Court agreed with the First-tier and Upper Tribunals, but disagreed with the Court of Appeal. The court held that the question as to whether a document is inaccurate can be answered only by looking at the document as a whole. Contrary to the Court of Appeal's view, the use of the wrong boxes was cancelled out by the full and frank explanation elsewhere on the return as to what was being achieved and why.

> The Supreme Court disagreed with both decisions reached by the Court of Appeal, yet nevertheless dismissed HMRC's appeal.

On the question of staleness, however, the court upheld HMRC's position and concluded that the statutory regime imposed no requirement on HMRC to issue a discovery assessment promptly after a discovery was made, but for the ordinary four year, six year and 20 year time limits. Thus, subject to underlying public law principles considered further below, there was nothing to stop HMRC making a discovery of a deliberate under-assessment soon after the tax return was received, but failing to make an assessment for another (say) 15 years. In the same vein, the court said it did not matter how many different officers made the relevant discovery: as long as the officer making the assessment believed it to be justified, that was all that the statute required.

Commentary

It will be noted that, on the two issues before it, the Supreme Court disagreed with both decisions reached by the Court of Appeal, yet nevertheless dismissed HMRC's appeal. This is because HMRC needed to win on both points and the Supreme Court and the Court of Appeal simply disagreed as to which point was to be won by Mr Tooth and which would be decided in HMRC's favour. Nevertheless, the point does illustrate the fact that all litigation is unpredictable.

In relation to the deliberate inaccuracy point, the court's decision restores the law to what it had always been assumed to be. One part of the court's reasoning was the fact that the tax return contains white spaces, with the express purpose of permitting taxpayers to provide additional context for the entries made (or perhaps not made) elsewhere on the return. HMRC tried to dismiss the relevance of these white spaces on the basis that they are not analysed by HMRC's computer which initially reviews the returns when submitted. The court, however, was not impressed. As the judgment says:

‘If they [HMRC] sensibly include ample white spaces in their approved form of online returns so as to ensure that the taxpayer is not constrained by the limitations of the boxes for figures from making a correct and complete return, then they cannot thereafter assert, for the purpose of advancing a non-contextual interpretation of one or more boxes, that their computer cannot read what is written on the white spaces.’

However, this then leads to the question as to what taxpayers should do when submitting returns (particularly VAT returns) that do not allow for any similar explanations. My provisional view is that an explanatory letter sent to HMRC at broadly the same time as the return is submitted should suffice. However, HMRC’s retreat from geographical postal addresses makes even that precaution increasingly difficult to implement in practice.

As someone who has been involved in many of the cases which established the principle of staleness, I cannot fail to be a little disappointed that the concept has been now discredited by the highest court of the land. If I might indulge myself a little, I note that the Upper Tribunal in Pattullo v HMRC [2016] UKUT 270 had concluded that ‘the requirement for the discovery to be acted upon while it remains fresh appears to me to arise on the natural meaning of s 29(1) itself’ (my emphasis). Now, the Supreme Court is telling us that ‘the idea that a discovery which qualifies as such should cease to do so by the passage of time … is unsustainable as a matter of ordinary language’ (again, my emphasis). Tax law is known to be confusing but matters are not helped when two completely conflicting opinions are both justified on the basis that the statutory language is clear.

However, the decision is not necessarily bad news for taxpayers who wish to challenge HMRC delays in dealing with their cases. Indeed, I have seen many taxpayers latch onto the concept of staleness and argue that this might be a trump card for them. However, in most such cases, the taxpayers have been subject to a statutory s 9A enquiry which has not been actively progressed by HMRC for many years. The former concept of staleness was relevant only to discovery assessments and, indeed, was based on the lower courts’ and tribunals’ interpretation of the word ‘discover’. Accordingly, the knock-out argument that might have been deployed in a discovery case was unavailable to those taxpayers who were within the enquiry regime. However, the Supreme Court’s judgment might now give such taxpayers a new glimmer of hope. All HMRC investigations (whether ultimately concluding with a closure notice or with a discovery assessment) must be conducted in accordance

with public law principles. As the Supreme Court concluded:

‘[HMRC] must act rationally, must not abuse their powers and may be required to respect any legitimate expectation which they have created. If they fail to do so, the taxpayer may seek relief in judicial review proceedings.’

> The law is now clear: one does not drill down into a document to find isolated errors; instead, entries on documents have to be read in their proper context.

The Supreme Court commented that a deliberate decision by HMRC not to assess promptly might amount to irrationality which might in turn provide the basis for a judicial review claim; however, it declined to explore in detail the practical implications of those principles. In my view, it was wise to take that approach. Nevertheless, it will not surprise me if the next few years see a trickle of cases where staleness arguments will be given a fresh airing in judicial review claims.

What to do next

For any advisers dealing with cases where HMRC is alleging deliberate conduct, particularly in the context of a penalty assessment or to justify a late discovery assessment, such cases should now be reviewed in the light of the Supreme Court’s decision. The law is now clear: one does not drill down into a document to find isolated errors; instead, entries on documents have to be read in their proper context. Any alleged deliberateness has to relate to the inaccuracy itself and not merely the decision to make the relevant entry on the document.

So far as staleness is concerned, tax advisers must now consider whether the facts justify commencing a judicial review. If so, such matters must be referred to legal experts extremely promptly, because (in practice) judicial review claims are subject to far more stringent time limits than those ordinarily encountered in tax dispute resolution.