Embiricos: the scope of partial closure notices

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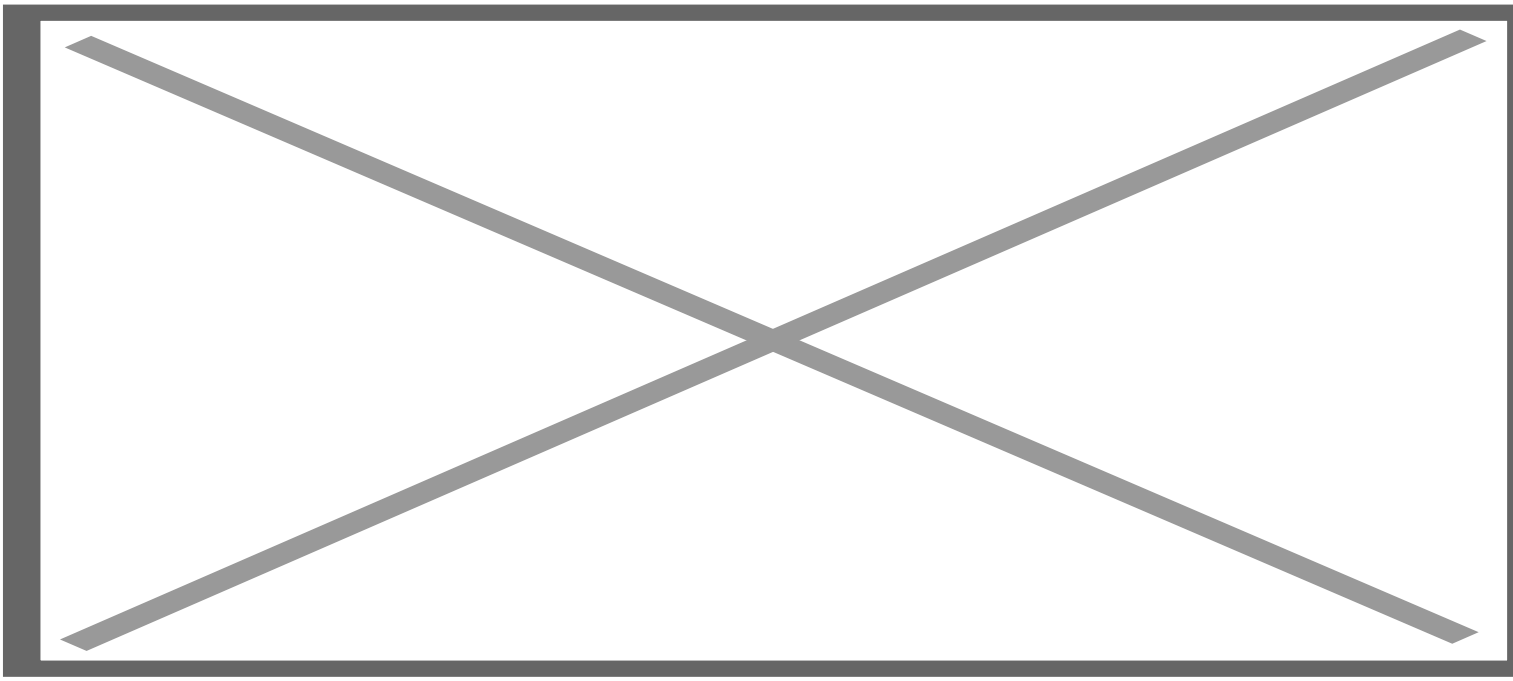

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The Court of Appeal's view of the scope of partial closure notices is set out in the case of *Embiricos v HMRC*.

Key Points

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What is the issue?

HMRC was concerned about taxpayers who had entered into multiple avoidance schemes in the same tax year. It was unable to challenge a particular scheme through the tribunals until it could issue a closure notice, which it could not do until each avoidance scheme had been fully investigated.

What does it mean for me?

Partial closure notices were introduced by the Finance (No.2) Act 2017. The unanimous view of the tax profession was that flexible closure notices were a good idea, but the procedure had to work in favour of both HMRC and the taxpayer.

What can I take away?

In the case of *Embiricos v HMRC*, the Court of Appeal held that in a domicile dispute, a partial closure notice which disallows a remittance basis claim may be issued only if it also goes further by identifying additional

income or gains to be brought into the charge to tax.

The original Self-Assessment code was drafted almost 30 years ago and it might be said that its age is showing in places, although some enhancements and modernisations have been introduced piecemeal over the years.

One potentially welcome change was the introduction of partial closure notices by the Finance (No.2) Act 2017. These were first mooted in the 2014 Autumn Statement with the proposed name 'flexible closure notices'. It had become apparent to HMRC that, until then, the closure notice process had a singular disadvantage in that an enquiry into a return could not be closed until all strands of HMRC's investigations into a particular tax return had run their course.

Although this was a minor problem in most cases, HMRC was concerned about taxpayers who had entered into multiple avoidance schemes in the same tax year, the enquiries into which were progressing at different speeds. In such cases, HMRC was unable to challenge a particular scheme through the tribunals until it could issue a closure notice; and that was something that it could not do until each avoidance scheme had been fully investigated.

It should also be noted that I had come across a case where HMRC had issued a closure notice prematurely, inasmuch as the taxpayer who was party to a number of different schemes received a closure notice which reflected HMRC's view of one scheme but before other scheme investigations had concluded. This meant that the taxpayer was not subject to HMRC's adverse conclusions in relation to those other schemes.

Those with a close knowledge of the Taxes Management Act 1970 would know that the above concern could have been sidestepped by a reference to the tribunal under s 28ZA partway through an enquiry. Section 28ZA allows the parties to take any question that arises in the course of an enquiry to be resolved by the tribunal as if there were a full appeal on the point. Indeed, the tribunal's conclusion (as modified in the course of any appeals to the Upper Tribunal or beyond) is binding on the parties so that the point cannot be re-argued in a standard appeal at the end of the enquiry.

However, s 28ZA is subject to some potential drawbacks. First, it requires both parties to consent to the matter being escalated to the tribunal. Secondly, a decision by the tribunal cannot lead to the taxpayer being required to pay any additional tax that he or she might now be known to be liable for – the crystallisation of the tax debt can follow only once the closure notice is given. Indeed, HMRC made clear in 2014 that part of its motivation for introducing flexible closure notices was to accelerate the time when tax debts would be payable. (Of course, the date from which interest would run would be unaffected.)

I remember cautiously welcoming the 2014 announcement, but perhaps for a different reason. I had recently seen a case where HMRC had covered a wide range of issues in relation to a taxpayer's affairs in the course of the enquiry into his return.

By the time I was instructed, most of the strands had been resolved (in that no further questions were being asked) and I was required to look at the final strand. Nevertheless, I was conscious that there was a risk that what might have been understood as an agreement by HMRC of the taxpayer's position in relation to those other strands might be subject to a rude awakening (if HMRC were to announce suddenly that its earlier silence did not amount to acquiescence). Thus, I too could see the benefits of a procedure whereby discrete parts of an enquiry could be formally closed. As I said in a Tweet on the date of the Autumn Statement: 'Flexible closure notices seem like a good idea – both for HMRC and taxpayers. Can they be implemented properly? One can but hope.'

However, over the following weeks, it transpired that HMRC's plans were somewhat different from what I (and others in the profession) had envisaged. HMRC wanted a procedure whereby it could close down aspects of a taxpayer's enquiry (and therefore accelerate a tax payment), without the corresponding right of taxpayers to obtain some certainty in relation to matters that had been resolved in their favour. The unanimous view of the tax profession was that flexible closure notices were a good idea, but the procedure had to work both ways.

HMRC, it seems, accepted the criticism and I was invited to join a small panel to work up a set of proposals that would bring some symmetry to the process. The aim of those proposals would be:

- to permit HMRC to issue partial closure notices (as originally put forward by HMRC); but
- also to enable taxpayers to ask (and, if necessary, to apply to the First-tier Tribunal so as to direct) HMRC to issue such partial closure notices.

The proposals were enacted as part of the Finance (No.2) Act 2017.

The extent to which the 2017 changes have met their objective is the subject of the Court of Appeal's recent decision in *Embiricos v HMRC* [2022] EWCA Civ 3.

The facts of the case

Mr Embiricos was born in Greece and had a domicile of origin there. However, by the time of the 2014/15 and 2015/16 tax years, he was resident in the UK. Mr Embiricos has taken the view that he has not acquired a domicile of choice in any part of the UK (and has instead retained his Greek domicile of origin).

On the basis of his view as to his domicile status, Mr Embiricos considered himself entitled to be taxed on the remittance basis, so that non-UK income and capital gains would be taxable in the UK only to the extent that Mr Embiricos remitted the income or gains to the UK. Accordingly, in his returns for each of those two tax years, Mr Embiricos ticked the box to indicate that he wished to be taxed on the remittance basis.

HMRC opened enquiries into Mr Embiricos's tax returns, with the enquiries focused on Mr Embiricos's domicile status. After just under two years, HMRC concluded that, contrary to his own views of the matter, Mr Embiricos had in fact acquired a domicile of choice in a part of the UK and was therefore not entitled to be taxed on the remittance basis. As a result, Mr Embiricos would be liable to UK tax on his worldwide income and gains (irrespective of whether or not he had remitted the sums to the UK).

HMRC duly asked for details of Mr Embiricos's non-UK income and gains in the two tax years in question, with a view to issuing closure notices that would bring those sums into charge. However, Mr Embiricos felt that HMRC was not entitled to that information – not at least until the question of Mr Embiricos's domicile status had been resolved.

HMRC then issued formal Schedule 36 notices seeking the details of Mr Embiricos's non-UK income and gains, against which Mr Embiricos duly appealed. Mr Embiricos also applied to the First-tier Tribunal for a direction that the enquiries be closed. However, he then amended his application so as to ask for partial closure notices instead. Such partial closure notices would (on the basis of HMRC's view of Mr Embiricos's domicile status) involve an amendment of Mr Embiricos's tax returns, amounting to the removal of his remittance basis election in each year. If such partial closure notices were issued, Mr Embiricos could then appeal against them and argue that he had not lost his Greek domicile and, accordingly, was entitled to have his remittance basis claim reinstated.

The First-tier Tribunal agreed with Mr Embiricos, but HMRC appealed to the Upper Tribunal. The Upper Tribunal allowed HMRC's appeal: it concluded that it would not be possible for the amendments accompanying a partial closure to be limited to the removal of a remittance basis election. Instead, according to the Upper Tribunal, amendments by a partial closure notice must have a direct impact on a taxpayer's tax computation. In other words, it would have been possible for a partial closure notice to lead to the removal of a remittance basis claim, but only if HMRC could also increase the taxable income and gains and (if relevant) remove the remittance basis charge.

Mr Embiricos appealed against the Upper Tribunal's decision to the Court of Appeal.

The Court of Appeal's decision

The case came before Lady Justices Nicola Davies and Simler and Mr Justice Francis. Lady Justice Simler gave the main judgment, with the other two judges giving concurring judgments.

Lady Justice Simler referred to the various policy documents published at the time of the original proposal in 2014 and also when the revised scheme was announced in 2016 and introduced to Parliament in 2017. She summarised the policy objectives in the following terms:

> '[I]t seems to me to be clear that while a plain purpose of the changes was to make the enquiry process more efficient and flexible for both HMRC and the taxpayer by enabling early resolution of one or more aspects of an enquiry while other matters continue to be investigated, there was another equally important purpose. This was to provide greater finality by early resolution of discrete matters at the enquiry stage, and thereby accelerate the payment and collection of tax.'

The judge was referred to the rarely invoked provisions in s 28ZA which permit a tribunal to consider 'any question arising in connection with the subject-matter of the enquiry' and held that this confirms that the word 'matter' means something wider than merely any discrete question that might arise in the course of an enquiry.

Furthermore, as the judge continued, the structure of the partial closure notice rules in s 28A is so closely modelled on the previous rules for closure notices (and those now for final closure notices), it must be taken that the consequences following a final closure notice should generally be assumed to apply to partial closure notices as well. She continued by noting that both partial and final closure notices are statutorily deemed to 'take effect when … issued' and likened this to tax assessments which is what closure notices in effect usually are. This was then taken as the basis for concluding that partial closure notices must have a substantive tax effect, this being a major distinction between closure notices and any question that might be referred to the tribunal under s 28ZA.

The judge acknowledged that immediate tax effects are not an inevitable consequence of closure notices, even if the closure notices do lead to some amendments to a taxpayer's return. However, the judge held that, in the present context – a domicile dispute – a partial closure notice which disallows a remittance basis claim may be issued only if it also goes further by identifying additional income or gains to be brought into the charge to tax.

For these reasons, Mr Embiricos's appeal was dismissed.

Commentary

In my respectful view, the court reached the wrong decision as it does not sit comfortably with a straightforward reading of the legislation. Indeed, the learned judge did concede that she was initially attracted to 'the apparent simplicity and logic' of the taxpayer's argument. In short, Mr Embiricos argued that where the legislation

defines the potential scope of a partial closure notice as ‘any matter to which the enquiry relates’, there is no rule that prevents ‘any matter’ from being indeed any matter. Similarly, there is nothing in the legislation itself that requires ‘any matter’ to read as if it said that ‘any matter that could on its own lead to a quantifiable change in the taxpayer’s tax liability’.

Indeed, the potential scope of statutory enquiries is expressly defined in Taxes Management Act 1970 s 9A as ‘anything contained in the return, or required to be contained in the return, including any claim or election included in the return’. Furthermore, the statute contains a safeguard to prevent taxpayers from taking the right to ask for a partial closure notice to a ridiculous extreme, because the tribunal has the power not to accede to a taxpayer’s request (see the Court of Appeal’s decision in *Eastern Power Networks plc v HMRC* [2021] EWCA Civ 283).

However, as noted above the court felt that the policy papers justified the narrower reading of the partial closure notice regime. It is my respectful view that the court erred in this respect.

First, it would be wrong to place too much reliance on the 2014 papers because the later legislation was drafted so as to overcome their acknowledged shortcomings. Secondly, the revised provisions were heralded by the following statements (as cited by the judge, but with my emphasis and annotation):

- ‘A partial closure notice will **almost always** [i.e. but not every time] be followed by HMRC making an amendment to the tax return and that **may** mean more tax is payable.’
- ‘where HMRC issues a partial closure notice and makes an amendment to the tax return, taxpayers will be able to appeal against, and apply for postponement of, **any** [i.e. not ‘the’] tax arising from the amendment’.

In short, by 2016, there was nothing in the (then proposed) statutory scheme that automatically linked a partial closure notice (and any subsequent appeal against it) to an immediate tax liability.

The court also took some comfort for its views by seeking to minimise the overlap between the scope of any appeal against a partial closure notice and what might have been the subject of a joint referral to the tribunal under s 28ZA. However, I think that there are three reasons as to why the court was wrong to be so comforted:

- First, it is beyond doubt that there is a difference in the potential scope of the two procedures.
- Secondly, the ability of taxpayers to seek a partial closure notice unilaterally can be partly seen as a response to HMRC’s general refusal to consent to s 28ZA referrals, with the tribunal able to act as arbiter as to whether the process is being used appropriately.
- Thirdly, as noted by the Supreme Court in the *Rangers* case: ‘The legislative code … has developed over time to reflect changing governmental policies in relation to taxation … As a result, the legislative code is not a seamless garment but is in certain respects a patchwork of provisions.’ Accordingly, some overlap is not surprising.

For me, the most persuasive reason given by the court was a point about HMRC’s own powers to issue partial closure notices without compulsion. In particular, it could be possible to conceive of a case where, under the current statutory residence test, an individual would be held to be UK-resident for a particular year if at least one of three facts is established. As the court pointed out, having too narrow a definition of the word ‘matter’ could mean that a partial closure notice might be issued in relation to one of those three facts, leaving the other two unresolved. In such a situation, the taxpayer might be required to appeal against three separate partial closure notices, each potentially involving a separate trip to the tribunal.

However, for two different reasons, even this argument does not fully answer the question before the court. First, just because one can identify a situation in which the word ‘matter’ is applied to a very narrow element of a dispute but with unattractive procedural consequences, it does not mean that the meaning of the word ‘matter’ has to be limited to a very wide aspect of the enquiry. Secondly, the unattractive procedural consequences are more imaginary than real because a tribunal is most likely to accede to any request for all aspects of the case to be brought together (rather than be litigated separately). Furthermore, were HMRC to issue a partial closure notice in respect of one narrow element of the enquiry, a tribunal is going to need very good arguments as to why other, related parts of the enquiry, should not be closed at the same time.

What to do next

I would like to think that this case would attract the interest of the Supreme Court (assuming that Mr Embiricos wishes to take the matter further). However, the issue might be considered a bit too niche to get admitted by that court.

Assuming, therefore, that this is the final word on the subject, what can taxpayers do when faced with an assertion by HMRC that they are UK-domiciled but they dispute that assertion and do not wish to (or cannot) provide details of non-UK income or gains pending determination of that fundamental question? There is an answer and that is to challenge any formal information notice seeking the details of the non-UK income and gains. That should allow the taxpayer’s domicile to be considered by the tribunal and that would then answer the question as to whether the non-UK income and gains information will need to be provided.

However, HMRC disputes the validity of that approach as well (as evidenced by the recent cases of *Levy*, *Henkes* and *Perlman* which have been decided differently). Indeed, the sad irony is that Mr Embiricos probably foresaw such problems, which is why he modified his strategy to ask for a partial closure notice. Fortunately, it is likely that the appropriateness of the Schedule 36 route will be considered by the Upper Tribunal at some stage in the next year.