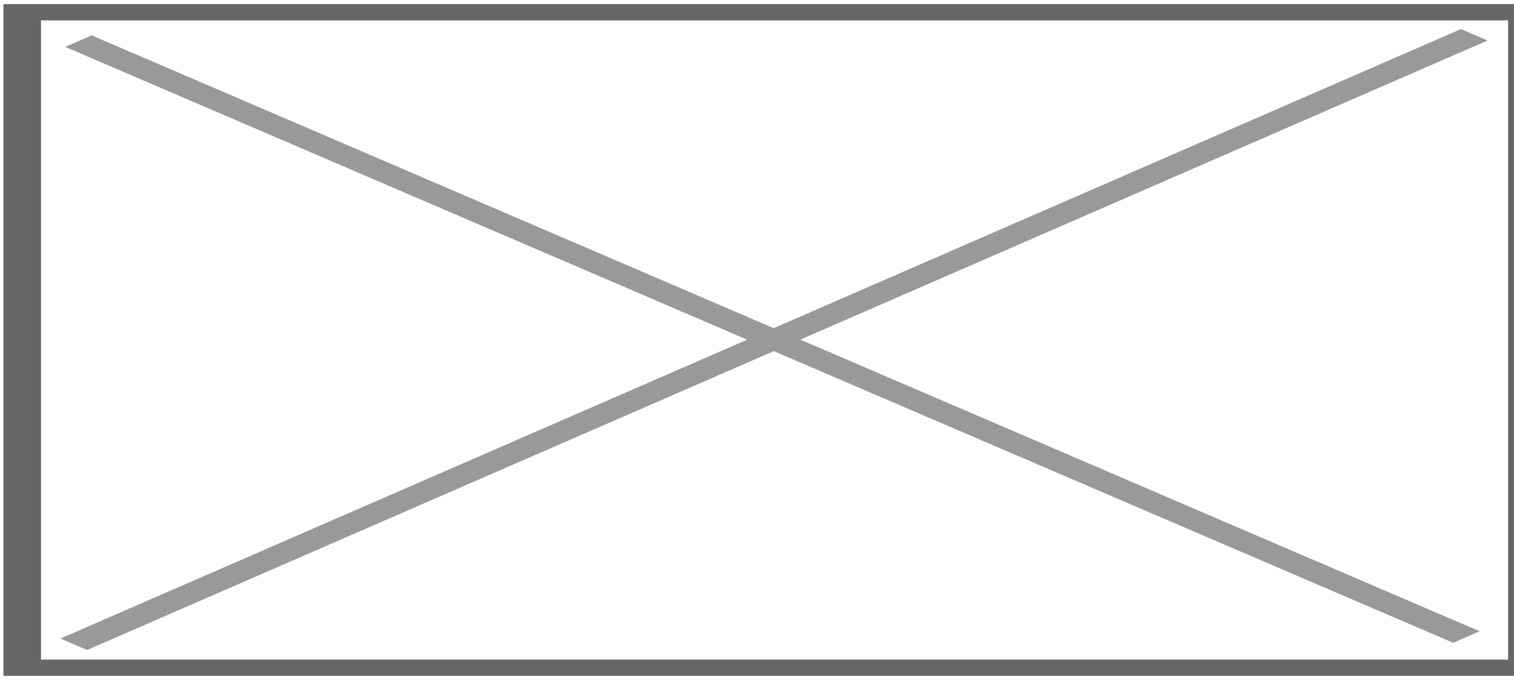
Cumming-Bruce v HMRC: Enquiries into capital loss claims

Personal tax



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The case of *Cumming-Bruce v HMRC* considers the appropriate method for an enquiry into capital loss claims.

Key Points

What is the issue?

The case of *Cumming-Bruce v HMRC* [2022] UKUT 233 relates to the method of enquiring into claims for capital losses which are incurred in one tax year and carried forward to a subsequent tax year.

What does it mean for me?

In cases where HMRC is challenging the existence of capital losses brought forward from earlier years, advisers should check the statutory basis of HMRC's challenge.

What can I take away?

If there has been no enquiry into the return in which the losses were first said to arise, there is a strong argument that HMRC may not attack the losses via an enquiry or discovery assessment in relation to the later year when the benefit of the losses is enjoyed.

Lying at the heart of the Self Assessment system is HMRC's power of enquiry. As a general rule, HMRC is given free rein to examine anything in a tax return (or that is supposed to be in a tax return) provided that they commence an enquiry within 12 months of the return being submitted. The more detailed rules are found in section 9A of the Taxes Management Act 1970.

If a matter is not picked up in the course of an enquiry, HMRC may instead address any perceived under-assessment by way of a discovery assessment. However, reflecting the fact that this is only a backstop power available to HMRC, its rights to make a discovery assessment are more restricted.

One might have thought that the scope of any potential enquiry was fairly straightforward. Indeed, as I have already noted, it can cover anything in a tax return (or that is supposed to be in a tax return). However, along came the case of *HMRC v Cotter* [2013] UKSC 69. In this case, a taxpayer had included in his tax return (in the specific box allocated for such claims) a claim for employment losses incurred in a subsequent tax year and carried back as per the trading loss rules. HMRC did not accept that the losses were correctly calculated and sought payment of the tax that would have been due on the return as if the loss claim had not been made. The taxpayer argued that as the loss claim had been made in the taxpayer's return, HMRC was obliged to give effect to the loss claim (in the absence of any valid enquiry into the return itself).

The Supreme Court disagreed with the taxpayer. It held instead that the loss claim was not in fact made on any part of the tax return (merely on a part of the tax return *form*). Accordingly, HMRC was not obliged (or even able) to challenge the loss claim via an enquiry into the return. Any challenge to the losses had to use the procedures for challenging claims made otherwise than on a tax return (Taxes Management Act 1970 Sch 1A).

An explanation for the distinction between 'the tax return' and 'the tax return form' is often given as distinguishing between those elements that do and those that do not feed into the calculation of the taxpayer's tax liability for the year. (Carried back losses are by statute treated as pertaining to the later year, even if the value of the relief is computed by reference to the income and tax rates of the earlier year.) As a result, it was held in *Cotter* that the losses did not feed into the tax calculation for the earlier year and, therefore, the claim was not a part of the earlier year's return.

The decision in the *Cotter* case gave rise to two further cases which reached the Supreme Court and a further one which ended in the Court of Appeal. Those cases all concern income tax and the carrying back of losses. However, the recent case of *Cumming-Bruce v HMRC* [2022] UKUT 233 represents a further variation on the theme, this time being the method of enquiring into claims for capital losses which are incurred in one tax year and carried forward to a subsequent tax year.

The facts of the case

The full background to this case can be summarised by the simple (but, probably to some, cryptic) phrase: '*Mansworth v Jelley* losses'. This phrase describes a pretty embarrassing saga which started almost exactly 20 years ago when the former Inland Revenue lost a case in the Court of Appeal concerning the computation of capital gains (or losses) following the exercise of employee share options. The case was particularly fact-sensitive (notably the fact that the employee was non-resident at certain key times).

However, the Revenue then issued a widely criticised statement seeking to generalise the outcome of the case and invited thousands of wealthy executives (i.e. not just those who had been non-resident on the key dates) to make capital loss claims in respect of their share options. Despite the widespread criticism of the Revenue's unjustified largesse, it was only in 2009 that HMRC then resiled from its earlier position and publicised its revised view that the capital loss claims that it had invited thousands of individuals to claim would no longer be accepted.

By this time, many repayments had been made by the former Inland Revenue. However, particularly in relation to workers at banks and other City institutions, the Revenue had actually opened enquiries into the tax returns on which these capital losses had been claimed. These enquiries were then kept open for many years (officially because there were parallel enquiries into the individuals' employers). Following the official change of view, HMRC started to close down the enquiries and recompute the capital losses/gains in accordance with the correct view of the law.

Mr Cumming-Bruce's particular situation was typical. More precisely, he claimed capital losses on his 2001 and 2002 tax returns which were both the subject to enquiries under section 9A. As those losses exceeded his capital gains for the relevant years, the losses were carried forward and eventually set off against capital gains as realised in later years. In most of those later years, HMRC too had opened enquiries. However, in respect of one year, HMRC failed to open an enquiry and instead made a discovery assessment. In the end, however, nothing turned on that distinction.

Mr Cumming-Bruce argued that, according to the *Cotter* decision, the capital loss claims were outside the scope of the 2001 and 2002 enquiries. There were two reasons behind this argument.

First, as a matter of principle, he argued that capital loss claims are always made outside the tax return (and, merely on the tax return *form*).

Secondly, as the losses did not reduce the tax payable for the enquiry years (but only those later years in which sufficient gains were made), the ratio of the *Cotter* decision meant that his particular loss claims were in fact made outside the returns and therefore susceptible only to enquiries under Schedule 1A, rather than under section 9A.

The tribunal's decision

The case made its way to the Upper Tribunal where it came before Judges Thomas Scott and Anne Redston.

The Upper Tribunal rejected both aspects of the taxpayer's case.

In respect of the first argument, the tribunal noted that to be allowable capital losses, the taxpayer is first required to notify HMRC. Furthermore, the Taxation of Chargeable Gains Act 1992 s 16(2A) expressly provides that such a notification is to be treated as if it were a claim for relief, which is subject to the rules in the Taxes Management Act 1970 s 42. Section 42 provides that claims should generally be made on a tax return where possible and this then ensures that any enquiries into such claims are governed by the section 9A provisions, rather than those in Schedule 1A.

The Upper Tribunal similarly dismissed the taxpayer's second argument. Whilst it noted that the losses did not feed into the tax calculation for the years in which the losses were said to have arisen, the Upper Tribunal considered that 'feeding into the calculation' was not a necessary condition that defined the boundary between the tax return and the tax return *form*. Instead, it was, at best, a gloss based on the facts of the *Cotter* case.

Indeed, the Upper Tribunal cited examples as to how the taxpayer's argument could lead to some confusion. For example, in a case (best understood if one overlooks the annual exemption) where a taxpayer had two losses of

£100 and one gain of £100, how can it be determined which of the two losses is within the tax return and which is merely on the tax return form: in other words, which is governed by section 9A and which by Schedule 1A?

Furthermore, suppose it transpired that the taxpayer had in fact made greater gains than declared on the return. This could lead to a loss newly feeding into the tax calculation of the year. It cannot be the case that an item on the tax return form is treated as within the scope of a section 9A enquiry only in the light of extraneous circumstances.

For these reasons the appeal was dismissed.

Commentary

It is my view that the Upper Tribunal has reached the obviously correct result in this case. Nevertheless, it is difficult not to have some sympathy with the taxpayer in the present case. He was positively invited by the Revenue to make a claim for capital losses and, I believe, his returns were subject to enquiry only because of a parallel investigation into his employer's affairs.

Arguably, he would have had a very good right to ask for those enquiries to be closed long before HMRC then changed its mind (again) about the scope of the *Mansworth v Jelley* decision. Furthermore, it was still a few more years before HMRC actually took steps to reverse the loss claims. Any unfairness would have been exacerbated had the taxpayer actually crystallised capital gains in the Revenue-induced belief that they would be relieved by the brought forward losses.

On the other hand, the losses were always illusory. I can remember some of the consternation nearly 20 years ago that executives were being given a windfall tax break because of what was thought by most to have been an obvious case of Revenue error.

That said, I take the view that the concepts of fairness should apply equally to all, and they should not be whittled down simply on the basis that one party is considered to be less deserving (i.e. wealthier) than another.

Although it is hard to know what is lurking beyond the visible horizon, I suspect that the *Cumming-Bruce* case brings to a close the 20 year saga of *Mansworth v Jelley* losses.

On a separate point altogether, I was particularly interested in the case because it seems to reinforce an argument I have advanced in other cases. Although the Upper Tribunal's discussion was focused on the appropriate procedural steps that should be taken if HMRC wishes to challenge capital losses when they are incurred, it must be remembered that the tax impact of the decision was felt only in the later years when those losses were set against capital gains. The case has seemingly proceeded on the basis that the losses were not validly calculated.

The question that might then be asked is why HMRC did not challenge them in respect of the later years. The answer is that the statute appears to take the view that losses from earlier years are automatically deductible (whether or not originally claimed correctly) unless the losses are expressly challenged at the time that they are first claimed and carried forward.

HMRC's approach to this case suggests that it too agrees with that interpretation, although I am not aware that it has formally conceded the point. Nevertheless, the Upper Tribunal's decision would seem to reinforce that argument.

What to do next

In cases where HMRC is challenging the existence of capital losses brought forward from earlier years, advisers should check the statutory basis of HMRC's challenge. If there has been no enquiry into the return in which the losses were first said to arise, there is a strong argument that HMRC may not attack the losses via an enquiry or discovery assessment in relation to the later year when the benefit of the losses is enjoyed.