[2016] UKFTT 0171 (TC)

TC04947

Appeal no: TC/2015/02899

Capital Gains Tax - Application to add a new ground of appeal in the Appellant's substantive appeal to be heard at a later date - Whether HMRC can dispute, in an open Enquiry, whether the terms of the taxpayer's return, made in accordance with then guidelines from HMRC, can be amended to rectify what HMRC now claim is an error - Decision that there is a sufficient chance that the Appellant's new ground is correct for it to be admitted - Application allowed

FIRST-TIER TRIBUNAL

TAX CHAMBER

ANDREW SCOTT

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: JUDGE HOWARD M. NOWLAN

Sitting in public at the Royal Courts of Justice in London on 19 February 2016

Michael Firth, counsel, on behalf of the Appellant

Tom Cleaver, counsel, on behalf of the Respondents

DECISION

Introduction

1. This was an Application by the Appellant to add a new ground to its grounds of appeal in a substantive hearing to be heard at some future date.

2. The circumstances leading to the present Application are slightly involved, but the point presently in dispute is as follows. The Appellant claims that his tax returns for the periods 2006/7 and 2007/8, both of which were the subject of open enquiries by HMRC, contained calculations of tax either actually made by HMRC, or made under software itself generated by HMRC's calculations and software made available to taxpayers. HMRC has made adjustments to the two returns in the open enquiries, essentially doubling the tax chargeable on capital gains in the two years, based on the claim that the returns were incorrect. Since the claimed errors in the returns were themselves based on HMRC's own calculations or indications to taxpayers as to how returns should be prepared, the Appellant claims that it is not permissible, in an enquiry, for HMRC to enquire into its own calculations and its own errors and to make amendments designed to correct such claimed errors.

3. The slightly complicated way in which this issue arises was broadly explained to me, though it was irrelevant for the parties to explain, or for me to understand, the full detail. The relevant points, however, are as follows.

4. The Appellant appears to have anticipated that he would be realising very substantial chargeable gains for Capital Gains Tax purposes in the two relevant tax years. In those years, Capital Gains Tax was chargeable at 40% unless the taxpayer's level of income was below the threshold at which the tax rate on his income moved from 20% to 40%. Where that was the case, then an amount of the gain, equal to the amount by which the 40% income tax starting figure exceeded the taxpayer's actual income was chargeable at the 20%, rather than 40%, rate. To give a simple example, if the taxpayer's income was £10,000 below the threshold figure at which he would be liable for 40% tax on his income, then £10,000 of the chargeable gain would be taxed at 20%, and the excess at 40%.

5. In the present case the taxpayer had obviously implemented a scheme geared to the calculation of higher rate tax in relation to insurance policies. I was not given any of the details of the scheme that had been implemented, but I was told that the taxpayer claimed to be entitled to extremely large deductions in respect of the steps that he had implemented in relation to the insurance policies. Whether the following assumption is correct or not is not particularly significant, though by way of example it seems that the deduction could have arisen as follows. Where one holder of a relevant insurance policy takes a payment in a year in excess of the 5% tax free amount that may be withdrawn from the policy, the excess amount is then treated as taxable income for higher rate tax purposes. When the policy is finally surrendered, further calculations are made and if the amount that had been treated as income exceeds the true total gain on the policy (taking into account the cost of the premium, the amounts received in withdrawals under the policy and the final amount received on surrender), the person surrendering the policy is given a deduction to ensure that the overall taxable amount does not exceed the true gain on the policy. This deduction is given to the holder surrendering the policy, regardless of whether the earlier holder that took the excess

distributions on the policy may both have been a different person from the person surrendering the policy and a person not in fact liable to tax on the relevant income amount.

6. It seems likely that in the present case the steps in relation to the insurance policy or policies will have been calculated and designed to generate a sufficient deduction for the present Appellant, both to ensure that none of his income in the relevant years would be taxed at more than 20% and so also that the balance of the deductions, not used to reduce the rate of tax on income, would be sufficient to ensure that the entire capital gains in the two relevant years would also be taxed at 20% and not 40%.

The facts

7. The Appellant's tax returns for both relevant periods indicated that the rate of tax on the very large chargeable gains was only 20%. In the period 2006/07, the Appellant supplied the figures of income and gains (which are not in dispute) and HMRC themselves calculated the tax on the capital gain at the rate of 20%. In the period 2007/08, the Appellant made his return electronically. On this occasion the Appellant's accountant used software based on the calculations from HMRC that indicated that the relevant rate of tax on the capital gains would again be 20% and the return was made accordingly.

8. There is no dispute that HMRC had opened enquiries into the tax returns for both periods and HMRC is now challenging the proposition that the deductions claimed in respect of the insurance policy or policies can potentially reduce the rate of tax on capital gains from 40% to 20%. We are unaware of the substantive points being advanced in that regard and they are presently irrelevant.

9. The Appellant sought to bring a judicial review action against HMRC to establish that when HMRC had indicated that the relevant rate of tax was 20% the Appellant had some legitimate expectation that that was indeed the proper rate so that HMRC could not subsequently apply the higher rate. The written and oral applications to bring judicial review proceedings were rejected, however, on the basis that there had been no unequivocal representation that the tax rate would be 20%. The Appellant did not appeal these decisions and therefore no full judicial review hearing took place.

10. The Appellant then applied to the Tribunal to amend its substantive case before the Tribunal to add to the substantive ground for alleging that it was indeed correct that the appropriate rate of tax on the capital gains was 20% the new contention that since the tax shown on the original returns had either been calculated by HMRC themselves at 20% or inserted on the electronic return in reliance on indications from HMRC, HMRC could not properly, in pursuing "enquiries", enquire into their own calculations and recommendations. The proper subject of enquiries was to enquire into the taxpayer's calculations and interpretation of the law and not to undermine or reverse HMRC's own calculations and instructions.

The law

11. There is no dispute that HMRC has opened enquiries in relation to the two returns, and therefore the particular statutory provision in issue in this Application is section 9A(4)(a) Taxes Management Act 1970. This provides that:

"An enquiry extends to anything contained in the return, or required to be contained in the return including any claim or election included in the return."

The Appellant's contentions

12. The Appellant advanced the following contentions:

- When section 9A (1) refers to the fact that *"an officer of the Board may enquire into a return"* it must be implicit from the natural meaning of the word "enquire" that the enquiries should be confined to cross-checking the presentation from the taxpayer both as to the facts and the law, and it is not apt for the officer to re-consider calculations and instructions actually made by HMRC;
- When the self-assessment provisions were introduced, there was no intention to change the effect of decisions such as *Scorer (Inspector of Taxes) v. Olin Energy Systems Ltd* [[1985] STC218, to the effect that when an Inspector had agreed a return with a taxpayer on the basis of the provision of full information and in circumstances in which a reasonably competent officer would have appreciated what the correct treatment should be, HM Revenue should be precluded from raising a discovery assessment. In the present case, HMRC had implicitly agreed the calculations and so should only be able to make further assessments under the "discovery" provisions.
- On the Respondents' contentions the taxpayer would have no remedy or cause of action in pursuing his understandable quest for finality when tax had been calculated in an amount based on HMRC's own calculations or guidance. Judicial review would have been refused on the ground that no unequivocal representation had been made and that was because HMRC had actually calculated the tax rather than made unequivocal representation as to how it should be calculated. If, therefore, HMRC are not to be precluded from changing their own calculations during an enquiry, the taxpayer would have no finality when making a return based on HMRC's calculations and instructions, and Parliament cannot have intended that result.
- Where the taxpayer fails to make a return at all and HMRC calculate the taxpayer's taxable income and gains, HMRC has no opportunity to open enquiries into those calculations. It would be perverse for the taxpayer to have more finality in that situation where the taxpayer had made no return at all, in contrast to the situation asserted by the Respondents in the present case.
- Finally, and on a different subject, it was stressed that it was not necessary for me to decide that the Appellant's argument was correct on the balance of probability in order to admit the new ground of appeal. In considering whether to admit the new contention, I simply needed to reach the conclusion that there was some chance that the contention was correct.

The Respondents' contentions

13. The Respondents contended that:

- The interpretation that the Appellant sought to put on the word "enquire" was not justified.

- The strict statutory enquiry in this case was not geared to the wording of section 9A (1) which refers to the fact that *"an officer may enquire into a return"*. There is no dispute that there are open enquiries into both returns. The relevant point in this case is rather the interpretation of section 9A (4)(a) which deals with what an enquiry may extend to. In that regard, the relevant paragraph says that *"an enquiry [may] extend to anything contained in the return …."* It does not say that it can only extend to the content of the return derived from the taxpayer's own representation of the facts and interpretation of the law. It can extend to anything contained in the return.
- The discovery provisions do respect the proposition that once an enquiry has closed there must be some finality and therefore there are certain safeguards against discovery assessments being made today when earlier returns were for instance based on the prevailing interpretation or application of the law when the assessment became final and any enquiry closed.
- The Appellant's claim that Parliament could have intended to give a taxpayer finality, and protection from later changes at any time when an enquiry was still open, is unrealistic. It is far more realistic to suppose that Parliament would have intended, in the enquiry period, that the essential aim would be for tax to be computed correctly and not for HMRC to be bound by earlier indications or calculations that came to light prior to the end of the enquiry period. Once an enquiry had closed, then later further assessments would be governed by the rules applicable to discovery assessments whereupon the taxpayer would be able to rely on earlier assessments that had been made on the basis of prevailing practice at the time.

My decision

14. There are two factors in this Application that have a bearing on what my decision should consider, and pragmatically what is sensible.

15. The first point is that I am not required to decide whether, on the balance of probability, the Appellant's contentions are correct, but simply whether there is a sufficient chance that they are correct that admitting the new ground of appeal would not be pointless. If I considered that there was no chance that the point advanced by the Appellant was valid, it would merely waste time and over-complicate the eventual hearing to admit the new point.

16. There is, however, a pragmatic point which may have nothing to do with the validity of the Appellant's point but I do consider that it is relevant. This is that if I were to refuse to admit the new point, this could well lead to two distinct disputes between the parties that could not, it seems, proceed in one hearing through the upper courts. If I rejected the Application, one possibility is that the Appellant would appeal against my decision to the Upper Tribunal, and possibly to higher courts, but all that litigation might be pointless even if the Appellant eventually prevailed, if the Appellant later lost the appeal on the substantive point. If, to take the other possibility in the event of my refusing the present Application, an appeal against my refusal to admit the new point was stayed in order to allow the appeal in relation to the substantive point to be heard, if the Appellant ultimately lost that appeal, the Appellant could then appeal the "enquiry" point, and might eventually succeed on that point. Both these scenarios do, however, involve the consequence that there could be two distinct

points in dispute and that it would seem difficult, if not impossible, for both to be amalgamated for combined appeals to the higher courts. By contrast if I now admit the new ground of appeal, such that the First-tier Tribunal hearing the main appeal will have to deal with the "enquiry" point and the substantive point, then inherently the decisions of that Tribunal will be capable of being appealed together to and through the higher courts.

17. My decision is certainly not wholly influenced by the pragmatic point just made. It is nevertheless that while on the balance of probability I decide that the Respondents' case in this Application would have prevailed, I cannot refuse to admit the requested new point because I do not consider that it has no chance, or no realistic chance, of success.

18. The reasons why I consider that, had the test been one of the balance of probability, the Respondents would have prevailed, are as follows:

- The Appellant has to place too much reliance on the meaning of the word "enquire" and I would have rejected the proposition that the notion of the enquiry was confined to considering facts and legal interpretations advanced by the taxpayer.
- Even if, when considering the interpretation of section 9A (4)(a) the opening word "enquiry" has the meaning contended for by the Appellant, it is still difficult to dispute that an enquiry has certainly been opened, and when the relevant paragraph clearly indicates what can be dealt with in the enquiry it seems odd to find other restrictions buried in the claimed meaning of the word "enquiry".
- There appears to be some consistency in considering the point at which Parliament intends the taxpayer to be able to rely on "finality". In *Olin* it seems clear that if there had been discussions between HM Revenue and the taxpayer in which the Inspector had initially indicated that he expected to be able to allow the offset of the losses against the profits of the only continuing trade, but before making the assessment on that basis the Inspector suddenly realised that his approach had been wrong, I do not consider that the Inspector would have been precluded from denying the offset of the losses and making an assessment accordingly. Similarly in the present day case where HMRC make an assessment on a taxpayer who has not filed a return, it seems obvious that even if for some period HMRC suggests that it will adopt one approach but then changes that approach before making the assessment, there can be no objection to that change of approach, even though it will inherently not involve, and cannot involve, opening an enquiry. Consistently, therefore, in the present situation if HMRC had not changed their basis of calculation and the enquiry had been closed on the basis that the assessment would be left with the rate of tax being 20%, then the ability to make a later change to that, and a further assessment, would all revolve around the discovery provisions and the feature of the original assessment having been based on a full provision of the facts and the "then prevailing application of the law". But if the change, on the part of HMRC, occurs during the period when the enquiry is still open, it seems to me that the better view is that HMRC can change their initial stance, and effectively reverse the initial basis of calculation in the open return.

19. I nevertheless decide that the Appellant's point is certainly not "unarguable", and I accordingly allow the Appellant to advance this new point in the substantive Appeal.

Right of Appeal

20. This document contains full findings of fact and the reasons for our decision in relation to each appeal. Any party dissatisfied with the decision relevant to it has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) Tax Chamber Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 07 MARCH 2016