TC01317

Capital gains tax - whether discovery assessments were valid - whether sub-section 29(1) TMA 1970 permitted a discovery assessment to be made when no new facts or changed view of the law had emerged - how the notional officer should be considered to approach the question posed by section 29(5) TMA on the basis of the information deemed to be available to him - Appeal allowed

FIRST-TIER TRIBUNAL **Reference nos: TC/2010/4511**
TC/2010/4513
TC/2010/5204

TAX

DR. MICHAEL CHARLTON
MRS. BARBARA CORFIELD
MR. JOHN CORFIELD

Appellants

-and

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS
Respondents

Tribunal: HOWARD M. NOWLAN (Tribunal Judge)
RUTH WATTS DAVIES

Sitting in public at 45 Bedford Square, London on 2 and 3 June 2011

Keith M. Gordon, counsel, instructed by Premier Strategies Limited, on behalf of the Appellants

Akash Nawbatt, counsel, on behalf of the Respondents

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DECISION

Introduction

1. This case related to whether HMRC had made valid discovery assessments on the three Appellants, thereby denying artificial capital losses that the three Appellants had hoped to secure by participating in the tax year 2006/2007 in a marketed tax scheme promoted by Tenon Limited ("Tenon"). The majority of the material facts were not in dispute.

2. The case thus involved a dispute in relation to the legal provisions concerning discovery assessments, first as regards the meaning of the word "discovery" in sub-section 29(1) Taxes Management Act 1970 ("TMA"), and secondly as regards the meaning and the proper application of the provision in sub-section 29(5) TMA.

3. Sub-section 29(5) precludes a discovery assessment from being made unless it can be said, at the end of the one-year period in which HMRC can open enquiries in relation to a taxpayer's self-assessment return, or on the notification to the taxpayer that such enquiries have been completed, that an average HMRC officer "could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware [*that the taxpayer's return failed to assess income or capital gains that ought to have been assessed, or that the return claimed excessive reliefs*]".

4. 41 taxpayers had effected the scheme promoted by Tenon in the two tax years, 2005/2006 and 2006/2007, the three Appellants all in the later year

5. It was not material for us to understand how the scheme was meant to operate, and accordingly we never enquired into the detail of the scheme. Briefly, however, it appears that in order to generate an artificial loss, each taxpayer purchased an existing life assurance policy for a considerable sum; then effected a very substantial partial surrender; and finally sold or surrendered the small balance of the policy.

6. Whilst a small overall economic loss was made, comparing the purchase price with the amounts received on the partial and total surrenders, the amount received on the partial surrender was said to be excluded from the consideration amount for capital gains purposes on the grounds that "it had been taken into account for income tax purposes".

7. Whilst this was the purported basis for excluding the proceeds on the substantial partial surrender from the capital gains calculation (so occasioning the enormous loss), no income was actually assessed. We imagine that this resulted from the way in which there is a chargeable event on partial surrenders of policies in which the proceeds, or all but 5% of the proceeds, are treated as income, albeit that this initial treatment can be reversed if, on the final surrender of the policy, there is in fact no profit (and thus no "income") should the amounts received on all partial surrenders of the policy and on the final sale or surrender of the policy fall short of the purchase price of the policy. Obviously the claim was that, in some way, the revised income tax analysis, following final surrender, that accounted for the absence of any charge to income tax did not derogate from the argument that at the point of the partial surrender, a substantial amount had been taken into account for income tax purposes and that it was still appropriate to deduct that vast amount from the consideration in the capital gains calculation.

8. By the time the three Appellants in this case, and doubtless by the time all 41 participants in Tenon's scheme, submitted their self-assessment tax returns, HMRC

had challenged a broadly similar scheme promoted by a different company, and certainly by the time the three Appellants had submitted their returns, the Special Commissioner (Sir Stephen Oliver Q.C.) had decided that the scheme in that case failed to achieve its object and that the losses were not allowable. We understand that there were differences between the scheme in that other case (namely *Jason Drummond v. HMRC* [2007] STC (SCD) 682) and the scheme promoted by Tenon, but we were also told that it appeared that the basis on which Sir Stephen Oliver had decided the *Drummond* case would equally undermine the Tenon scheme.

9. We understand that all 41 participants in the Tenon scheme inserted similar references to their scheme in their tax returns. Certainly the three Appellants did.

10. The Appellants' tax returns all revealed the large capital gains that had been made, and then set against those gains the losses of broadly similar amounts that they hoped would be available. In the "white spaces" in the tax returns, sufficient details of the insurance policy transactions (all of which we will quote in full below) were given for us instantly to reach the understanding of the scheme reflected in paragraphs 5 to 7 above.

11. All of the tax returns also indicated that the Appellants had implemented a scheme that had required prior disclosure to HMRC, as a potential "tax avoidance" scheme, under the Disclosure regime, generally referred to as the DOTAS rules, first introduced in Finance Act 2004. As required, the tax returns also revealed the particular scheme's Scheme Reference Number ("SRN"), namely 50448445, under those DOTAS rules.

12. The tax returns did not however make any mention of the *Drummond* decision, or of the fact that those advising the Appellants must have known, by the time the returns were submitted, that HMRC was challenging schemes of this nature. No general reference was made to the feature that the claim for the losses, assumed in producing the very modest figure of net capital gain in the returns, was based on a view of the law (almost certainly a genuine view at the time) that was at variance with the view that HMRC obviously held, having challenged the schemes that occasioned the *Drummond* case, and equally obviously at variance with the decision that Sir Stephen Oliver had reached.

13. By the time the so called "enquiry window" for reviewing taxpayers' self-assessment returns had closed, three things had occurred. Firstly enquiries had validly been opened in relation to the tax affairs of 38 of the 41 taxpayers who had implemented the Tenon scheme. In due course, all 38 accepted that the losses were not available. Secondly, HMRC had thought that it had opened an enquiry into the return of one of the three Appellants, but it later accepted that it had failed to send the relevant letter. No attempt to open an enquiry in relation to the other two Appellants had even been attempted. Thirdly, the High Court had affirmed Sir Stephen Oliver's decision.

14. Mr. Cree, the HMRC officer tasked with dealing with the Drummond/Tenon type schemes then discovered after the "enquiry window" had closed that the three Appellants had effected the Tenon scheme, and that in their cases HMRC had failed to open enquiries. He admitted that this was through oversights on the part of HMRC personnel, and that obviously the simplest and most correct course would have been for enquiries to have been opened in relation to the three, as in the case of the 38. He doubtless considered that he still had the opportunity to raise "discovery" assessments, but to save issuing assessments that might have to be

vacated if the *Drummond* taxpayer succeeded in his appeal to the Court of Appeal, he waited until the Court of Appeal had also affirmed Sir Stephen Oliver's decision and until it became clear that there was to be no appeal to the Supreme Court, before issuing the discovery assessments.

15. The task for us was simply to decide, in principle, whether those discovery assessments were valid or not. There were one or two computational matters that would need to be agreed between the parties in relation to the calculation of the capital gains on the "other" assets, but we were expressly told to ignore that and just reach a decision on the issue of whether the discovery assessments were valid.

16. Our decision is that they were not valid.

17 Whilst the dispute between the parties focused on two fundamental questions (the right interpretation of sub-section 29(1) TMA and the right interpretation and application in this case of sub-section 29(5) TMA), there were a considerable number of sub-issues that we need to consider. The clearest way in which to deal with all these matters is to deal in order with:

- the legal provisions that we must interpret;
- a slightly fuller summary of the facts, and evidence, and a full quotation of everything relevant in the Appellants' tax returns; and then
- each distinct contentious point, in turn.

In dealing with each relevant contentious point, we will first raise the question in dispute, then summarise the contentions of the respective parties, then give our decision on each point and the reasons for that decision, along with the supporting authority for the decision.

The relevant legal provisions

18. It is unnecessary to summarise the surrounding law in relation to self-assessment, enquiries, closure notices, the closing of the window in which enquiries can be raised on a self-assessment return, and the finalisation of such returns. Briefly, HMRC has roughly a one-year period in which to open enquiries in relation to self-assessment returns, which then remain operative (permitting claimed adjustments to the return) until the Closure Notice is issued. The provisions in relation to discovery then permit additional assessments within various time periods where the provisions of section 29 TMA, which we will quote below, permit. Very full descriptions of the whole process in relation to self-assessment, enquiries and Closure Notices, and to some extent the discovery provisions are contained in the decisions of Dr. Avery-Jones in *D'Arcy v. HMRC* [2006] STC (SCD) 543 and in Lord Justice Moses' decision in the Court of Appeal in *Tower Mcashback LLP1 & another v. HMRC* [2010] EWCA Civ 32.

19. The sub-sections of section 29 TMA that are relevant to these Appeals are as follows:

> *"29 __Assessment where loss of tax discovered__*
>
> *29(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment-*

(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
(b) that an assessment to tax is or has become insufficient, or
(c) that any relief which has been given is or has become excessive,

the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax."

Sub-section (2) is irrelevant to this appeal. It provides that where a taxpayer's return is shown to have contained some insufficient assessment, no discovery assessment can be made if the understatement was due to an error as to the basis on which tax liability ought to have been computed, and the basis adopted in making the return was *"in accordance with the practice generally prevailing at the time when it was made"*.

"29(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above-

(a) in respect of the year of assessment mentioned in that subsection; and
(b) in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

29(4) The first condition [in fact irrelevant to these Appeals since no suggestion of fraudulent or even careless conduct was alleged by HMRC] *is that the situation mentioned in subsection (1) above is attributable to fraudulent or negligent conduct on the part of the taxpayer or a person acting on his behalf.*

29(5) The second condition is that at the time when an officer of the Board-

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or
(b) informed the taxpayer that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

29(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if-

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;
(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in

which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer; or

(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above-

(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or

(ii) are notified in writing by the taxpayer to an officer of the Board.

29(7) In subsection (6) above –

(a) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes-

(i) a reference to any return of his under that section for either of the two immediately preceding years of assessment; and

(ii) where the return is under section 8 and the taxpayer carries on a trade, profession or business in partnership, a reference to any partnership return with respect to the partnership for the relevant year of assessment or either of those periods; and

(b) any reference in paragraphs (b) to (d) to the taxpayer includes a reference to a person acting on his behalf."

Sub-section 29 (7A) is presently irrelevant.

29(8) An objection to the making of an assessment under this section on the ground that neither of the two conditions mentioned above is fulfilled shall not be made otherwise than on an appeal against the assessment".

Sub-sections (9) and (10) are not relevant to these Appeals.

20. Whilst no other statutory provisions are relevant to these Appeals, there is considerable case law to which we will need to refer. Just as the Appeals have raised distinct points under sub-section 29(1) and sub-section 29(5) so different authorities relate to the distinct points.

21. Sub-section 29(1) is substantially a re-write of the equivalent provision that operated prior to the introduction of self-assessment, and indeed for very many years before that introduction. In this context the battleground between the parties was all in relation to the meaning of the simple requirement that an officer of the Board must "discover" some sort of "understatement". The basic point of contention was this. Whilst there would clearly be a discovery if the officer of the Board discovered new facts that had not been disclosed, and if a new view of the law was shown to be the correct view of the law (albeit then subject to the sub-section 29(2) saving provision),

could there be a discovery if for instance the original Inspector simply changed his mind, and concluded that there was an adequate ground for making a further assessment, or if a new Inspector took over the taxpayer's affairs and, without learning any new facts, simply reached a different conclusion from the original Inspector, and decided for his part that a further assessment was justified? We will address these questions in paragraphs 51 to 74 below.

22. There has also been considerable, obviously fairly recent, case law in relation to how we should apply the sub-section 29(5) provision that is meant to give the taxpayer some finality where the taxpayer has made an honest and complete return. This is achieved by asking the question, at the point when the enquiry window closes, whether a "notional officer of the Board " (generally regarded as an averagely competent Inspector), relying on the information that such Inspector is notionally assumed to have, would have reached the conclusion that there was an understatement in the return for any of the reasons mentioned in sub-section 29(1). Numerous different questions arise in relation to the proper application of the sub-section 29(5) test, and several cases have a marginal bearing on these issues, and we deal with these in paragraphs 81 to 127 below.

The facts in more detail, and the evidence

23. A perverse feature of this case is that it is not only unnecessary to record the facts in much more detail than we have already done in the Introductory paragraphs above, but indeed it would be counter-productive to do so. The whole point is that we must consider the proper application of sub-sections 29(1) and (5) entirely by reference to the information that the notional officer of the Board was notionally deemed to have by subsections 29(5) and (6). To enable this to be done, we will quote in full the relevant content of the Appellants' returns, several points about the feature that the scheme in question had been registered under the DOTAS rules, and one or two other points. The detail of the scheme, however, and any consideration by us of the degree to which it might have been undermined prior even to the making of the Appellants' returns by Sir Stephen Oliver's decision in the *Drummond* case seem to us not only to be irrelevant, but a quite wrong distraction from the points that actually matter in these Appeals.

The information given in the returns

24. The three returns made by the three Appellants, the figures apart, were identical. Taking as an example, thus, the return made by Mr. Corfield, this revealed net chargeable gains of only £1,626, with no resultant declared liability to capital gains tax, since the net gain fell well short of the annual exemption. Ignoring one or two details concerning taper relief, these net gains derived from there being gross gains in respect of disposals of quoted shares of roughly £197,825, and losses of £195,322.

25. The wording in the "white space" that explained the origin of the allowable losses was as follows:

> *"0.0000 shares were sold in Life Assurance Policy. I acquired an AXA Isle of Man Ltd life assurance policy on 27 October 2006 for £205303.92. Subsequently I made a partial surrender of the policy on 15 November 2006 for proceeds of £192577.45. I later sold my residual interest in the policy on 28 November 2006 for proceeds of £9981.41. The loss on sale is calculated as the difference between the sale proceeds and the cost of acquisition.*

Proceeds from the partial surrender are excluded from the capital gains calculation as they have already been taken into account as a receipt in computing income for the purposes of income tax"

It is worth noting in passing that the above text did not merely summarise the facts. Whilst it may not have given section numbers, it certainly explained the tax explanation as to why there had been a substantial capital loss, when there was only a small economic loss in respect of the policy.

26. In the "white space" in the return in relation to foreign income, the following explanation was given as to why no foreign income was being returned, in other words why there was no income derived from the AXA insurance policy:

> *"I acquired an AXA Isle of Man Ltd life assurance policy on 27 October 2006 for £205303.92. Subsequently, I made a partial surrender of the policy on 15 November 2006 for proceeds of £192577.45. I later sold my residual interest in the policy on 28 November 2006 for £9981.41.*
>
> *As the partial surrender and sale occurred in the final insurance year of the policy, the entries in boxes 6.6 to 6.8. relate to the disposal of the policy.*

Again we note that while the second paragraph quoted may not have explained the full law in relation to chargeable events in respect of policies and the further calculations in the final year, reference was certainly made again to the legal explanation for the lack of income in the tax return, and the disclosure was not confined to summarising the facts.

27. The final relevant disclosure in the tax return responded to the request for information under the following heading:

> ***Disclosure of tax avoidance schemes**. If you are a party to one or more disclosable tax avoidance schemes you must complete boxes 23.5 and 23.6. Give details of each scheme on a separate line. If you are party to more than 3 schemes give further details in the "Additional information" box, box 23.9, on page 10.*
>
> *23.5 Scheme reference number*
> *23.6 Tax year in which the expected advantage arises – year ended 5 April*

The answers given in relation to 23.5 and 23.6 were "50448445", and "2007".

The evidence and the other material facts

28. Evidence was given before us by Mr. Matthew Hall ("Mr. Hall"), a director of both Premier Strategies Limited and RSM Tenon Group PLC, all presumably related to Tenon itself, and by Mr. Malcolm Cree of HMRC ("Mr. Cree"). All of the evidence given was entirely straightforward and we have no doubt that everything said was entirely correct.

An element of "background" in relation to the scheme, our own limited knowledge, and the respect in which similar arrangements had already been challenged, and the particular way in which Sir Stephen Oliver's decision affected not only the Drummond scheme, but the Tenon scheme.

29. Whilst we reiterate that we ourselves have deliberately not looked up a word of the law in relation to either the Tenon scheme, the Drummond scheme, or the possible bases of challenge, much in this case revolves around how the reasonable Inspector should have reacted and responded to certain disclosures of facts, and it will be of some assistance for us to spell out some general observations in relation to the relevant areas of tax law.

30. Whilst we, as the members of the Tribunal, had conveniently been unfamiliar with schemes that we understand were generally described as SHIPs schemes (those letters standing for Second Hand Insurance Policy schemes), the way in which the schemes were designed to work was instantly obvious to us.

31. The schemes seemed to involve consideration of three areas of tax law. Since the schemes were designed to realise capital losses, vastly in excess of real losses, in respect of insurance policies, the three areas were:

- first, since gains to the first holder of a life policy were exempt, and losses not allowable for capital gains purposes, and the participants wanted to generate allowable losses, they obviously had to become "second-holders" of such policies;
- secondly, reliance was to be placed on the familiar section 37/38 TCGAct rules that exclude from the consideration received, and expenditure incurred on assets for capital gains purposes, amounts treated as trading receipts, or deductible trading costs of a trader for income tax purposes , and also exclude from the consideration any other amounts "taken into account for the purposes of income tax";
- thirdly, a provision is then needed that treats something as income for the purposes of income tax (so as to exclude that amount from the capital gains consideration under the previous bullet-point), albeit that the provision must then reverse the treatment (without undermining the point just mentioned), so that no income tax is actually charged. This element of the planning then involves perhaps the only slightly more complex area of law in relation to chargeable events on partial surrenders of life policies. These rules, which can throw up some quite extraordinary results, allow the holder of certain life policies to take a tax free 5% partial surrender as the end of each year for which the policy has been held. Should no partial surrenders be taken in years 1 and 2 for instance, then in or at the end of year 3, there can be a 15% tax free partial surrender. Partial surrenders in excess of those amounts are however treated as income for higher rate purposes, or in the case of a foreign life policy, for all income tax purposes. Under these rules, if a policyholder takes a 40%, or worse still, a 99% partial surrender before the end of year 1, then the whole amount is treated as income. This pays no regard to the fact that the amount received, coupled with the remaining value of the policy may even fall short of the amount given to acquire the policy in the first place, and most certainly not look like pure income or profit. To reverse this result, however, the rules re-calculate the income element on the final surrender or sale of the policy, so that income tax is eventually charged on only the actual real profit made. Any excess amounts earlier treated as income are then reversed to achieve this result.

  Implicitly the SHIPs scheme must have been based on the fact that by having an enormous partial surrender, transiently treated as generating income for income tax purposes, the capital loss would be created. And that result

would not be reversed, when on the final surrender of the policy (very shortly afterwards), nothing would actually suffer income tax.

32. We gathered that variants of the SHIP's scheme had been implemented for some years, because we were told that in 2003, the schemes were attacked by the insertion of an alteration into the provision (section 210 TCGAct) that conferred the exemption referred to in the first bullet point in the previous paragraph. This change was designed to limit allowable losses on such policies to the true economic loss.

33. The promoters of the Tenon scheme obviously thought that in some way they had circumvented the change made to section 210 TCGAct, and we were certainly told that when the scheme was implemented, two respected tax counsel, both now tax QCs, considered that the scheme achieved this objective.

34. The undermining of the scheme resulted from the fact that when the *Drummond* case came before Sir Stephen Oliver, he faulted it on the more general ground that in some way the provision of section 37 that ordinarily deducts from the consideration for capital gains purposes an amount that has been treated as income for income tax purposes did not apply. Whether this was because, in the event, the income analysis was reversed by the relief given on the final surrender of the policy we have not established. All that matters is that, whilst counsel and the promoters of the Tenon scheme, appear to have been optimistic that Sir Stephen Oliver's decision would be reversed on appeal, were it not to be reversed, the feature that it struck at the SHIPs planning under section 37, and not by circumventing whatever rule had been inserted in 2003 into section 210 TCGAct, would mean that the Tenon scheme would fail, just as the Drummond scheme had failed.

35. All three Appellants in this case submitted their Returns for the period 2006/07 in the Autumn of 2007, after Sir Stephen Oliver's decision had been released on 5 July 2007. During the enquiry window into those returns, which would close on 31 January 2009, the High Court affirmed Sir Stephen's decision on 23 July 2008. After the enquiry window had closed, the Court of Appeal did likewise on 25 June 2009, and leave to appeal to the Supreme Court was in due course refused.

The further material evidence

Mr. Hall's evidence

36. We accept, from Mr. Hall's evidence, that when the returns were submitted the two counsel who had been advising throughout still appeared to hold the view that the Tenon scheme worked. Implicitly they must have expected that the *Drummond* case would be reversed on appeal, or that at least the broad section 37 basis on which the decision had been reached would be reversed, even if the somewhat different *Drummond* scheme was still undermined on some other more limited ground that might not affect the Tenon scheme.

37. Whilst in due course we will address the points that the three Appellants' tax returns did not draw attention to the *Drummond* case, or to the fact that the planning underlying the Tenon scheme was planning that HMRC considered to be ineffective (possibly on the section 37 or other grounds), we certainly accept Mr. Hall's evidence that the disclosures in the returns were not meant to conceal anything. Tenon said that they expected that enquiries would be opened into the schemes undertaken by all 16 clients who implemented the scheme for the tax year 2006/07. In this expectation they were right as regards 12; no information was available as regards 1; an enquiry

was meant to be opened (but was not opened) into Mrs. Corfield's return, and there was a total failure to open returns in the case of the other two Appellants.

38. The other point to record from Mr. Hall's evidence was that when HMRC raised discovery assessment in respect of the three Appellants, they did this without asking for any further information or documentation from the Appellants. We might just observe in relation to this point that it does not necessarily indicate that the highly specialist officer, Mr. Cree, who made the discovery assessments, thereby accepted that he needed no other information in order to make the assessments. After all, by the time the discovery assessments were made, when it emerged that there was to be no further appeal against the Court of Appeal's decision, Mr. Cree had been making further enquiries into the 12 other cases, where enquiries had been opened.

Mr. Cree's evidence

39. Mr. Cree first described the operation of the DOTAS rules. He described how, when Tenon had initially submitted their AAG1 form, giving details of the Tenon scheme and relevant section numbers, the disclosure had been rejected as insufficiently clear and insufficiently informative. Following further correspondence, the information was provided in a form that HMRC considered satisfactory, and an SRN number was issued for the scheme.

40. Mr. Cree made the point that although HMRC itself obviously had all the information included in Tenon's AAG1 that was eventually accepted, the content of that AAG1 was not provided, with the Returns, by the Appellants. As the Appellants themselves were required to do, their returns disclosed the SRN number of the "avoidance scheme" that had been undertaken in the period 2006-07, but did not give section numbers material to the planning, or the AAG1, or (as already mentioned) any indication of the *Drummond* decision, or of any implicit conflict between the view obviously adopted on behalf of the taxpayers and that of HMRC.

41. Mr. Cree described the way in which weekly checks were made to ensure that whenever tax returns were received by HMRC, and those returns indicated that a scheme with an SRN number had been implemented by the taxpayer, procedures were in place to ensure that those officers in HMRC intimately involved with the disclosed scheme were able to inform relevant Inspectors dealing with the relevant taxpayers of how they should proceed, and, where appropriate, obviously where they should open enquiries into the returns.

42. On account of various slip-ups within HMRC, the procedures described in the previous paragraph failed to work. Even when a different checking mechanism, geared to identifying taxpayers who had disclosed the realisation of large losses flagged up the returns of Mr. Corfield and Dr. Charlton in September 2008 (i.e. still well within the enquiry window period), and it was then noticed that both returns included SRN notifications that had slipped below HMRC's radar scheme, those making these checks still managed in some way to fail to take the appropriate administrative steps to see that enquiries were then opened.

43. On January 8 2009 (i.e. about three weeks before the enquiry window would close for making enquiries into Mrs. Corfield's return), a letter was written to open such an enquiry on her return, but it seems that the letter was never sent. It was clear that it was never received, so that in her case also, no enquiry was opened.

44. Mr. Cree himself was the officer who had been in charge of coordinating all investigation in relation to SHIPs schemes, or at least those of the Tenon variety. He only gathered in March 2009 what had happened (or rather what had conspicuously not happened) in relation to the failures to open enquiries into the three Appellants' returns. He then called for the papers in order to ascertain whether assessments might nevertheless be made under the discovery provisions of section 29.

45. We will now quote several paragraphs from Mr. Cree's Witness Statement:-

> *"30 The papers arrived in SI Bristol on 24 March 2009. I reviewed them for the very first time at some point between then and 31 July 2009. Applying my detailed knowledge of HMRC's technical specialists' opinion contradicting how Tenon thought the scheme may work along with my own understanding based on the Court of Appeal's decision in Mr Drummond's case of the scheme's fundamental flaw, I discovered that both Mr. J Corfield's and Dr M. Charlton's self assessment tax returns were insufficient. By claiming capital losses to which they were not entitled both M. J Corfield and Dr M Charlton had understated the capital gains tax properly due.*
>
> *31. I then considered whether or not either tax return could be said to have clearly alerted a hypothetical officer of HMRC with a reasonable knowledge of tax to that insufficiency. Such an officer would have little or no knowledge of the legislation involved or how HMRC's technical specialist disagreed with Tenon's interpretation of its principles. They would have no knowledge about Mr. Drummond's appeal. Such things are of interest only to officers who are directly involved with the specific subject matter.*
>
> *32. Both Mr J Corfield's and Dr M Charlton's tax returns included almost identical information regarding the capital losses claimed, especially in the white space notes. Given this fact I assume that the wording was as advised by the promoter. They both declared the SRN at box 23.5 of the return. They claimed a capital loss on the initial part disposal and subsequent final disposal of a Life Assurance Policy. The information provided is some distance from a step by step analysis of the scheme. It contains no detail of the legislation that applies to each step and how that legislation was interpreted. It fails to even mention the legislation being interpreted in such a way as to create the loss claim. It does not mention that HMRC took a different view of the principles then in dispute despite the fact that Special Commissioner Sir Stephen Oliver QC's decision in the appeal of Mr. Drummond had been published on 5 July 2007, before the Appellants filed their tax returns, and that decision supported HMRC's view that the scheme did not work. The Appellants' returns do not mention Mr. Drummond's appeal despite the fact that Premier Strategies sent their clients regular updates on the ongoing appeal. I concluded therefore that the content of the tax returns could not be said to alert a hypothetical officer of HMRC to an insufficiency and that I was not prevented from issuing the discovery assessments.*
>
> *33. I mentioned at paragraph 9 above that form AAG1 comes from the scheme promoter and not the scheme user. I add at paragraph 12 that the content of the AAG1 must be sufficient for the officer conducting the initial review to identify the technical specialist to whom they should pass the AAG1. Notwithstanding the fact that the AAG1 was not submitted with any of the three tax returns in question in this appeal I have considered, had it been*

enclosed with the returns, whether it would have alerted a hypothetical officer of HMRC to an insufficiency of tax in those returns.

34. The Tenon AAG1 refers to 8 different sections of legislation spread across two different Taxes Acts (Income Tax Trading and Other Income Act 2005 and Taxation of Chargeable Gains Act 1992). Further, the AAG1 fully supports the efficacy of the scheme. It was prepared by specialists after considering research of the legislation and with the support of specialist Tax Counsel. Nowhere does it suggest that the scheme may be flawed or that HMRC might take a different view. I conclude that faced with this, and absent the knowledge held only by a handful of HMRC officers, a hypothetical officer of HMRC would know only that they were looking at a tax avoidance scheme and could not possibly conclude on this alone whether the scheme worked and therefore whether or not there was an insufficiency of tax in the returns of the participators in that scheme."

46. Mr. Cree then went on to explain that at this point he wrote to the Appellants, informing them that he was minded to raise discovery assessments. Perfectly sensibly he decided actually to delay making the assessments until he ascertained whether Mr. Drummond's case would be taken on appeal to the Supreme Court, since it would have been futile to make the assessments if HMRC were eventually going to lose on the fundamental point of principle that had been upheld by the High Court and the Court of Appeal.

47. Mr. Cree then made the discovery assessments shortly after it emerged that there was to be no further appeal to the Supreme Court.

Our decision - general

48. This case was hard-fought by counsel on the two sides. To give some idea of the extent of the contentions by counsel, even the Speaking Notes, which we were given for the Appellants' counsel's closing submissions ran to 81 pages.

49. To state the obvious, the case has nothing whatever to do with the merits of the Appellants' scheme. In one sense it is perverse that 41 out of the 44 participants in the Tenon scheme should have had, in the event sensibly, to abandon their claims for capital losses, whilst the present three Appellants will succeed, unless our decision is overturned on appeal, in being able to offset the same losses against their gains. That is entirely irrelevant. The only relevant point is that the conditions that have to be satisfied before a valid discovery assessment can be made and sustained are designed to give taxpayers some "finality", or "deserved finality", when their returns have been entirely accurate, and the question that we must address is how those conditions should be interpreted in striking the right balance between taxpayers and HMRC.

50. The contested points in this case fell into the two broad categories of:

- first, whether HMRC had to demonstrate that something new had emerged, when a discovery assessment was made, such as a new fact or a changed interpretation of the law (subject in that case always to the protection of sub-section 29(2)). In the alternative was it sufficient simply for the Inspector to change his mind, or for a new Inspector to take a different view from the original Inspector for the assessment to be valid? This question revolved entirely around the meaning of the word "discovery" in sub-section 29(1), and around the

correct interpretation of several old cases decided in the days before self-assessment. There are two other points of dispute on the wording of sub-section 29(1) that we will address after the fundamental point.

- Secondly, there was the whole issue of how to interpret and apply the test contained in sub-section 29(5), that being the test introduced with the introduction of self-assessment, and the test designed to give the taxpayer finality, when the information given in the return (and other permissible information in accordance with sub-section 29(6)) justified the conclusion "that the [HMRC] officer could .. have been reasonably expected [at the point when the enquiry window closed] to be aware of the situation mentioned in sub-section (1) above". The "situation mentioned in sub-section (1) above" was of course that there was some "insufficiency" (in a sense that we will have to explore below) in the tax that ought to have been assessed, as against that initially assessed.

The proper interpretation of the notion of "discovery" in sub-section 29(1)

51. We deal first with the fundamental question posed in the first bullet point of the previous paragraph.

52. The Appellants' contention was that while the "discovery" test presented HMRC with only a very low and modest hurdle to surmount in justifying a discovery assessment, something new had to emerge. The Appellants stressed the way in which the discovery assessments were made without any enquiries that revealed any new facts, and the feature that in the light of the decisions of Sir Stephen Oliver and the High Court (both of which pre-dated the closure of the enquiry window in relation to the Appellants' tax returns), the then law made it perfectly clear that at that point the Appellants could have been assessed. Since nothing new emerged after the closure of the enquiry window on 31 January 2009, no proper "discovery" had been made.

53. HMRC's contention was that it was sufficient to justify the making of a discovery assessment simply that an Inspector had changed his mind, or that a new Inspector had emerged and that new Inspector had taken a different view from the original Inspector. HMRC contended that the Appellants' case overlooked the fact that the authorities that required new facts to have emerged or for a different general view of the law to have emerged were relevant only when the initial assessment had been the subject of "a section 54 agreement". Those features (the emergence of new facts, of a changed view of the law) were thus key to reconciling the conflict between the law in relation to discovery, and the feature that when a section 54 agreement had been reached, the agreed assessment was treated as final, just as if the case had been determined by the Special Commissioners, or on appeal the courts, with no further appeal in prospect.

54. Before considering the authorities at some length, it may be clearest if we first give our decision on this first point, and summarise the reasoning that we believe emerges from the authorities, principally those of the three decisions (those of Mr. Justice Cross, the Court of Appeal and the House of Lords) in *Cenlon Finance Co. Limited v. Ellwood (Inspector of Taxes),* and the House of Lords' decision in *Scorer (Inspector of Taxes) v. Olin Energy Systems Ltd* [1985]1 AC 645.

55. Our decision on this first point is that, without any hesitation, HMRC's contention is correct. The yet earlier authorities, to which we will refer, make it

clear that it was sufficient to justify a discovery assessment that the Inspector had concluded that a further assessment was justified, regardless of whether new facts or a changed view of the law had emerged. Somewhat curiously the earlier authorities were on the strange point of whether this was just something that the Inspector might have concluded, or whether he required "legal proof" of this situation. In deciding that legal proof was irrelevant, the cases became authority for the proposition that a simple change of mind, or the different opinion of a new Inspector on unchanged facts and law, were sufficient to justify a discovery assessment.

56. The point in *Cenlon* was that the first Inspector had entered into a section 54 agreement, confirming that a particular dividend would not be assessed. When on unchanged facts the new Inspector took a different view and made a discovery assessment, the courts had to reconcile the fact that the discovery assessment was good (purely in terms of applying what is now sub-section 29(1)), with the fact that the subject-matter had been the earlier subject of a section 54 agreement which had made the agreed matter (that the dividend was not assessable) final and binding, just as if the point had been settled by the Special Commissioners or the courts on final appeal. The conclusion reached in each of the three courts was that the finality feature of the section 54 agreement did preclude the discovery agreement from being made, and it was only the resolution of the conflict with section 54 that undermined what would otherwise have been a valid discovery assessment.

57. For the sake of clarity, we should mention that we will adjust section references in early cases so as always to refer to the discovery point, as the point under "sub-section 29(1)", and we will refer to the "agreement" point as one under "section 54".

58. The significance of the *Olin* case was that whilst it was accepted, after *Cenlon,* that where an appeal had been settled by a section 54 agreement, this precluded a later discovery assessment, there was some doubt as to whether the section 54 "finality" rendered every aspect of the taxpayer's affairs reflected in the assessment "final", or whether it was just the matter that had been the particular subject matter of the dispute and the agreement that were fixed in stone. The entirely understandable conclusion was that it was only the matter that had been the subject matter of the dispute and the agreement that was finalised. Accordingly in *Olin* the conclusion was that the earlier Inspector's agreement had been precisely on the subject matter on which the new Inspector wished to sustain a discovery assessment, so that the new Inspector's assessment was invalid because of the "section 54 finality". Had the point discovered been something remote from the contentious (and then "agreed") issue of whether losses of a closed trade could be set against the profits of another trade, the new Inspector's discovery on some different point would not have been undermined by the section 54 finality.

59. Since the above conclusions are very important, and one or two references in very recent authorities can be quoted to throw doubt on those conclusions, we will make a number of references to relevant parts of the earlier decisions. We would ordinarily consider this to be slightly unnecessary since we are quite clear (having traced counsels' contentions and every aspect of the judgments at all levels in *Cenlon* and *Olin*) that HMRC's present contention, and the conclusions that we have just stated are correct, but for completeness we will quote the relevant passages that seem to us to put the points utterly beyond doubt.

60. Dealing first with the contentions of the parties, and later certain "admissions" by counsel in *Cenlon* before Mr. Justice Cross [1961] 1 Ch 50, Mr. Justice Cross referred to the contentions as follows:

"It was contended on behalf of the appellant company that:
(1) Formally, as regards years 1953-54, 1954-55 and 1955-56, there had been no discovery within the meaning of section 29(1), and that therefore, the additional assessments under appeal for all those years were not competent;

(2) As regard the years 1953-54 and 1954-55; (a) The proper officer of the Crown and the appellant had come to an agreement, within the meaning of section 54 on the specific point that the dividend … should not be included in the computation of the company's Case I profits.
………
(e) The effect of section 54 was that where a specific point had been determined on appeal and there was no appeal to the High Court, an additional assessment could not be raised under sub-section 29(1)".

61. Mr. Justice Cross then refers to the way in which:

"The issue between the parties has been narrowed by admissions made on each side. In the first place, the Crown admits that the correspondence between the inspector of taxes and the company's accountants in July and August 1955 constituted an agreement in writing within the meaning of section 54 for the variation of the estimated assessment in accordance with the figures put forward by the company. Secondly, the company admits that, having regard to the decision of the Court of Appeal in Commercial Structures Ltd v. Briggs, I must hold that when the new inspector acting on instructions from the chief inspector of taxes, took the view that the dividend in question was wrongly excluded from the company's accounts which had been submitted to his predecessor in July 1955 he made a "discovery" within the meaning of sub-section 29(1). The question at issue between the parties is, therefore, how far, if at all, is sub-section 29(1) controlled by section 54? Sub-section 29(1) does not itself place any limit on the time within which a "discovery" may be made. ……..[reference to time limits for ss. 29(1) assessments] Is the right to make additional assessments consequent on a "discovery" further cut down by section 54?"

62. We will not quote any passages from Mr. Justice Cross' decision itself, but we certainly record that having recited that he was bound to accept the lack of any limitation on the power to make a discovery itself, once an Inspector changed his mind or a new Inspector considered that his predecessor's approach had been wrong, his decision was entirely on the issue of whether the conflict with section 54 precluded the discovery assessment when the new assessment related to the matter that had been the subject of the section 54 agreement. He concluded that it did.

63. The following passages from Lord Justice Upjohn's decision in the Court of Appeal [1961] Ch 634, pages 649-651 are particularly helpful in relation to this issue of whether it is only the conflict between sub-section 29(1) and section 54 that precludes a discovery assessment in relation to some matter concluded by a section 54 agreement, unless the discovery agreement is on some quite new point not embraced by the section 54 agreement.

"It is not in doubt that the effect of section 54 is that if the Inspector comes to an agreement with the taxpayer, the effect of such an agreement is the same as if the point at issue between the inspector and the taxpayer had been determined on appeal by the commissioners. In this case, it is conceded by

the Crown that in each case the Inspectors did come to such an agreement with the company concerned to the effect that for certain years of assessment these tax-free dividends were to be excluded from the assessments in question. The question, therefore, may be posed very shortly: Is the Crown entitled to raise an additional assessment under the provisions of sub-section 29(1), notwithstanding either an agreement or an appeal which has been determined by the commissioners?

………

Before us, Mr. Shelbourne (counsel for the Appellant) *has properly conceded that we are bound by Commercial Structures Ltd. v. Briggs, so that, subject always to the point on section 54, the inspector is entitled to raise an additional assessment on the taxpayer merely because he has a change of mind as to the law applicable to the circumstances of the case, although no new fact or other event has subsequently emerged which would cause him to change his mind. Mr. Shelbourne reserves the right to challenge that case if the matter should go higher.*

…….

It seems to me that section 54 is directed to the case where a particular point has been determined, and when that point is determined it cannot be relitigated; both sides are bound. ……. If they are bound, both sides must be bound, and it cannot be open to the Crown, under the guise of an additional assessment under sub-section 29(1) to relitigate the very point, and in this case the only point, that has been agreed between the parties. On that short ground I would agree with the decision of the judge and of the commissioners."

64. A point to note from the judgment of Lord Justice Donovan's judgment is that he also records that the sub-section 29(1) discovery point might be challenged should the case go to the House of Lords, which of course it did. He said:

"The point is kept open by [the taxpayer] that there has been no "discovery" within the meaning of sub-section 29(1) so as to justify additional assessments, but merely a change of mind on the same facts for the same year. But this point is concluded by this court's decision in Commercial Structures Ltd v. Briggs".

65. In the House of Lords, the taxpayer was able to challenge the sub-section 29(1) point , and effectively contend that Lord Normand had been wrong in the *Commercial Structures* case to permit a discovery assessment under sub-section 29(1) where the Inspector had simply changed his mind and no new facts had emerged This challenge, in other words, was not based on the feature that discovery assessments on existing disclosures were ruled out in relation to particular matters embraced by a final decision or a section 54 agreement, but sought to narrow the scope for discovery assessments generally. The judgments were given principally by Viscount Simonds and Lord Denning. The result was that all five Law Lords affirmed the point in the *Commercial Structures* case that sub-section 29(1) itself permitted a discovery assessment, merely on a change of mind. It was only when there was conflict with a section 54 agreement that the section 54 point preserved the finality of the section 54 agreement and precluded the discovery assessment.

66. The following passage, at page 794 of Viscount Simonds' judgement in the House of Lords decision, [1962] AC 782 seems to us to be absolutely clear:

> *"I come to the second question which turns upon the true construction of sub-section 29(1). ….. The single question is whether the word "discovers" covers the case where no new fact has come to light but the revenue authorities have formed the opinion that upon a mistaken view of the law the taxpayer has been undercharged in his original assessment. Upon this question the Court of Appeal followed a previous decision of the court in Commercial Structures Ltd. v. Briggs. In that case the court, preferring a decision of Finlay J in Williams v. Grundy's Trustees to that of Rowlatt J in Anderton and Halstead Ltd v. Birrell and following a decision of the Court of Session, RC v. Mackinlay's Trustees, held that discovery had the wider meaning for which the Crown contended and contends in this case.* ***I think that that decision was clearly right and find the judgment of Lord President Normand wholly convincing. I can see no reason for saying that a discovery of undercharge can only arise where a new fact has been discovered. The words are apt to include any case in which for any reason it newly appears that the taxpayer has been undercharged and the context supports rather than detracts from this interpretation."*** *(our emphasis)*

Lord Denning's decision affirmed the same point, and the other Law Lords concurred.

67. We will not quote passages from the House of Lords' decision in *Olin,* but will simply reiterate that that decision is entirely consistent with the conclusions derived from *Cenlon,* and that it was principally directed to deciding whether the earlier Inspector had or had not agreed (i.e. obviously agreed wrongly) to the offset of losses of a closed trade against the profits of a continuing trade, in order then to identify whether the new assessment was indeed on the matter that had been the subject of the section 54 agreement. It was held that it was.

Recent case law references to the point of interpretation on sub-section 29(1)

68. Before addressing the second and third points to which we alluded in the first bullet point in paragraph 50 above, it would be wrong to ignore the fact that the Appellants drew our attention to one or two passages in recent decisions that they suggested indicated that the validity of discovery assessments under sub-section 29(1) (quite apart from the section 54 point) required some newly-discovered information.

69. One such reference was in the judgment of Lord Justice Auld in the recent case of *Simon Langham (Inspector of Taxes) v. Frederick Veltema* [2004] EWCA Civ 193. This case was fundamentally not on the sub-section 29(1) point at all, but was on how the sub-section 29(5) test should be applied. The taxpayer had disclosed a "benefit of employment", put at £100,000 in his return, geared to "Assets transferred to you £100,000", without indicating that the asset in question was the house in which the director lived, or that in due course the agreed valuation of the house would emerge to have been £145,000. Park J. had held in the High Court that it was reasonable to expect the Inspector to question the valuation. Had he done so, the Inspector could and should have opened an enquiry into the return, and could have made an assessment, on the basis of the information about the proper valuation that he would have obtained by the end of the enquiry window, such that having failed to do this, HMRC was shut out from making a discovery assessment.

70. The significance of Lord Justice Auld's decision is that Park J's decision was overturned, and it is now plain that in applying sub-section 29(5) the information that we must attribute to the notional "officer" in judging whether he could reasonably have been expected to be aware of the insufficiency in the assessment is just the information derived from the return, and included in the further paragraphs of sub-section 29(6). It is not information that a prudent and sensible Inspector might have been expected to obtain, were he to undertake further factual enquiries.

71. Whilst thus, the *Veltema* case is fundamentally concerned with the right application of sub-sections 29(5) and (6), the following passage was quoted to us as authority for the proposition that a discovery assessment could only be made if something new has emerged:

> *"The discovery procedure in section 29 has its origin in earlier tax statutes and may apply where, after normal finality of an assessment, some new fact comes to light or incorrect application of the law (subject to section 29(2)) or where, for any reason it newly appears that the taxpayer has been undercharged; see Cenlon Finance Co Ltd v. Ellwood, per Viscount Simonds at 203-204. Section 29 enables the Inland Revenue, where it discovers an insufficient assessment, subject to one or other of the two conditions, to make an assessment in the amount or further amount necessary to make good the loss of tax (section 29(1) and (3) TMA)".*

72. We do not accept that this passage indicates that the emergence of a new fact or a change in the application of the law is required to justify a sub-section 29(1) assessment. Whether the additional words "or, where, for any reason it newly appears that the taxpayer has been undercharged" are meant to refer to the simple situations where either the Inspector changes his mind, or a new Inspector takes a different view from his predecessor, either of those must justify the making of a discovery assessment. In terms of "newness", neither involves anything manifestly new, but both can sustain a sub-section 29(1) assessment.

73. There are also some references in Mr. Hellier's decision in *Corbally-Stourton v. HMRC* (2008) SPc 00692 and in Lord Bannatyne's decision in *Pattullo* [2009] CSOH 137 to features of "newness" that may be relevant in justifying an assessment under sub-section 29(1). Some or all may be referring simply to contentions of the parties and not to the reasoning underlying the decision itself on the proper interpretation of sub-section 29(1). Finally of course there is something "new" even where the original Inspector simply changes his mind or a new Inspector takes a different view. The newness in those situations is admittedly implicit in the very feature that an Inspector will self-evidently have decided in these cases that it is "newly appropriate" to make the discovery assessment, notwithstanding that in a common sense respect nothing actually new will have been discovered by HMRC. This point is graphically made in the last sentence of the extract from Viscount Simonds' judgment that we emphasised in paragraph 66 above. Having just made the clearest statement that in terms of sub-section 29(1) alone, a discovery assessment can be made notwithstanding that no new fact has been discovered, in the next sentence Viscount Simonds refers to the very feature of it "newly appearing to the Inspector that the taxpayer has been undercharged", in other words to that rather nebulous concept of newness, where nothing new has actually been discovered.

74. Whatever other references there may be, our firm decision on the sub-section 29(1) is that HMRC was correct on this point. A discovery assessment can be made merely where the original Inspector changes his mind, or a new Inspector takes a

different view. *Cenlon* at the House of Lords' level finally confirmed this, and clarified that it was only the conflict with a final decision on appeal or section 54 agreement that precluded discovery assessments, and then only as regards the matter that had been the subject of the final decision or the section 54 agreement.

The second point on the sub-section 29(1) issue

75. The next point that we address on the proper interpretation of sub-section 29(1) is that while we consider that it is only the conflict with section 54 that precludes a discovery assessment where no new facts have emerged, we need to consider whether the same result should follow under the self-assessment provisions when the enquiry window closes. Is there, in other words, equivalent wording at that point that occasions the same result of "finality", as in the case of final determinations by the First-Tier Tribunal or on appeal or under a section 54 agreement? This point was not specifically addressed by the parties though it was raised in an oblique way in one of the Appellants' counsel's closing submissions.

76. The answer to this point is that there is no such similar wording about finality, and thus no equivalent implication on the ability to make a discovery assessment under sub-section 29(1). Whilst this may seem surprising, it is entirely coherent in the light of the fact that it is sub-section 29(3) and in particular sub-section 29(5) that are clearly designed to furnish to the taxpayer the finality thought appropriate. It would indeed be slightly odd for there to be two distinct protections qualifying sub-section 29(1).

The third point on sub-section 29(1)

77. The third point on sub-section 29(1) is that because sub-section 29(5) refers critically to "the situation mentioned in sub-section (1) above", and a great deal hinges on deciding what this means, it is worth giving attention to the point, principally in the context of sub-section 29(1) itself at this point. The cross-reference is obviously to there having been some "insufficiency in the original assessment", but it is not clear whether, in judging whether the notional officer relevant under sub-section 29(5) is meant to be aware that the insufficiency was certain, probable or possible before HMRC is shut out from making a discovery assessment.

78. The prime relevance of sub-section 29(1) is that it permits the Inspector to make a discovery assessment. Aside from the point that the authorities have clarified that a mere new realisation or belief that there has been an under-assessment, rather than "legal proof" is all that the Inspector needs to assert in order to justify a discovery assessment, it must equally be obvious that an Inspector is not confined, in making a discovery assessment, to the self-evidently absurd requirement of having to demonstrate that the understatement is certain, and that the assessment he proposes is **bound** to be sustained, should the taxpayer appeal on the substantive points. It seems obvious to us that the officer merely needs to consider, in a *bona fide* manner, that as he now views matters, he has "reason to believe" that there has been an under-assessment, and that an assessment is now justified and that there is a reasonable likelihood that, were the taxpayer to appeal, the new assessment would be sustained.

79. This, thus, is the test that the Inspector has to consider in justifying a proposed discovery assessment, and when we consider the way in which sub-section 29(5) cross refers back to the "situation mentioned in sub-section (1) above", we will return to this point.

The conclusion on the sub-section 29(1) issue

80. Having now dealt with the three points that seem to us to be material on the interpretation of sub-section 29(1), we conclude that the Crown's argument has been fundamentally right on the proper interpretation of "discovery". It is only where there is conflict with some final determination of the First-Tier Tribunal, or the higher courts, or where there has been a section 54 agreement that the Inspector's liberty to make discovery assessments is cut down. Absent such conflict, it is clearly the case that the same Inspector can make a discovery assessment under sub-section 29(1) (prior to considering sub-sections (2) to (5)) on simply changing his mind, or that a successor Inspector can do likewise.

The proper interpretation and application of sub-section 29(5)

81. The question that we must now answer, under sub-section 29(5), is whether a notional Inspector, of average competence, could have been reasonably expected, on the basis of the information provided in the returns, and any other permissible information under sub-section 29(6), to have been aware at the time the enquiry windows closed (31 January 2009) "of the situation mentioned in sub-section (1) above".

82. One aspect of this test that is very clear is that the question that we must address is not whether at the relevant time the notional Inspector should have concluded that he should open an enquiry into the return. It is perfectly obvious that he should have done that in this case, and HMRC has effectively conceded that it was only through various administrative slip-ups that no such enquiries were in fact opened. It may, on the facts of the case, happen to be the case that it is reasonable to say that when it should have become clear to any Inspector that he should open an enquiry into the return (that obviously being the situation as soon as the return was submitted), there was also equal clarity that an immediate adjustment could have been made to the return had an enquiry been opened), and were the question at that point whether the facts would justify the making of a discovery assessment under sub-section 29(1), they would indeed have done so. Whilst, on the facts of this case, all three may happen to coincide, it is plain that the question that we must address is nothing to do with whether an enquiry should have been opened. It is "whether the situation in sub-section (1) existed", and however that test is to be defined, it is certainly geared to some level of clarity that a discovery assessment would have been justified at the closure of the enquiry window, and it has nothing to do with the wisdom of opening an enquiry.

The contentions on behalf of the Appellants

83. It was contended on behalf of the Appellants that the information given in the return, particularly that in the "white spaces" was sufficient to make the facts of the transactions that the Appellants had effected perfectly clear. From those facts, even ignoring the reference to the avoidance scheme's disclosed SRN, it was obvious that the Appellants had participated in a tax avoidance scheme.

84. It was wrong for HMRC to defend its discovery assessments by saying that "some schemes work and that others do not", and by then asserting that the notional Inspector would not have known of HMRC's relevant specialist officer's view that the Tenon scheme did not work, pursuant to the wide arguments under section 37, and would also not have known that HMRC's view had prevailed before Sir Stephen

Oliver. It might be right that in simple cases it would be appropriate for the notional officer to be treated as reaching his decision as to whether the notional facts revealed "an insufficiency" on his own, but in cases where it was clear that an actual officer would be expected to consult colleagues, it was equally pertinent to assume that the notional officer would obtain information about the law, HMRC's official view of the law, and information about actual judicial decisions by making relevant enquiries. This was all the more obviously so where the return revealed the SRN number of the scheme, as it was required to do, and when the feature that the SRN was given was plainly included amongst the information of which the notional officer was deemed to be aware.

85. In several of the decided case in relation to the application of sub-section 29(5), the validity of the discovery assessments had been sustained because the frame of mind even of the specialists within HMRC in relation to the then relevant schemes was that they had not decided whether the schemes worked or not, and quite possibly they needed more information before they could reach such a decision. By contrast in this case there was no such doubt. HMRC merely had to put "2 and 2 together", and link the clearly disclosed facts of the Appellants' schemes with the fact that the then state of the law, for the entire period of the enquiry window, was that the scheme did not work, so that amendments to the return, or (at the end of the enquiry window) immediate assessments were amply justified.

86. The Appellants' counsel contended that although the content of the AAG1, that had been filed by Tenon, was not provided with the return, or indeed "by the Appellants", the question posed by subsection 29(6) was whether the existence of the AAG1 could be inferred from the information in the return. Since the return had given an SRN for the scheme, and that reference number would not have been allocated until the relevant DOTAS officers had accepted the adequacy of the description of the scheme in the AAG1, the very existence of the AAG1 was something which the notional officer should have inferred. Since then HMRC had all the relevant information, the notional officer should be deemed to be aware of the content of the AAG1, giving all relevant section numbers in relation to Tenon's scheme.

87. It was significant that when the discovery assessment was made, no HMRC officer had actually obtained any further information from the Appellants, or indeed Tenon, in relation to the scheme undertaken by the Appellants, and that without any such further information or admissions about "insufficiencies", HMRC had felt able to make the discovery assessments. These facts both indicated an absence of any "newness" justifying the discovery assessments (an argument in relation to sub-section 29(1) which we have already dismissed), but they also indicated that whatever the actual officer, Mr. Cree, did in making the discovery assessments could manifestly have been done during or at the end of the enquiry window.

88. The assessments in fact made could thus have been made at any time after the returns had been submitted, and could and should have been made on the basis of the notional sub-section 29(6) information at the point when the window closed.

89. Accordingly the Appeals should be allowed.

The contentions on behalf of the Respondents

90. It was contended on behalf of the Respondents that the test in sub-section 29(5) required the taxpayer to have made it clear to the notional Inspector that there was an

actual insufficiency in the self-assessments made in the returns, not that there simply might be an insufficiency.

91. The test in sub-section 29(5) was a single test designed to be applied in countless different situations, and it was crafted particularly with more simple situations in mind. This is why the test required one to consider solely what the average Inspector would have known in relation to tax law, and it was wrong to assume that he might do any research in relation to the law. Consistently with the clear *Veltema* authority for the proposition that the Inspector should be assumed to make no further factual enquiries, but should base his conclusions simply on the information that he was deemed to have, the Inspector should base his approach just on what he knew about the law. If the wording of the test, crafted essentially to deal with simple situations, applied rather inappropriately where the notional officer would be manifestly "out of his depth", and precluded by the assumptions made by the Crown from seeking assistance or guidance from other colleagues within HMRC, that was simply unfortunate. Any test would be bound not to be appropriate in some situations.

92. In this case, the taxpayers made no mention of the fact that the view of the law on which they based their self-assessments was not the view that HMRC had obviously adopted, and that the taxpayers, and their advisors, would have known that Sir Stephen Oliver had endorsed. Yet no mention of this was made in the return to draw this feature to the attention of the actual Inspector. Absent those indications, the notional, averagely competent, officer could not, for the purposes of sub-section 29(5) be aware that the returns were insufficient. Indeed because his attention would not even have been drawn to the doubt that was plain to the Appellants and their advisers before the returns were submitted, the notional officer should be treated as being unaware of even the possibility of disallowing the capital loss.

93. We specifically put to counsel for HMRC the questions of whether the notional HMRC officer should be assumed to be at liberty to refer to the legislation, to any textbooks on tax, to the Inspectors' Manual or indeed to any other information that he might be able to access. We deliberately asked these questions, in that were counsel to confirm that the Inspector should undertake some research in relation to the relevant law, it would be a very small step for counsel then to have to concede that the notional Inspector might also take the staggeringly obvious step, which in reality HMRC would have expected the Inspector to take, namely to e-mail or phone the specialist colleagues, responsible for having considered the scheme whose SRN had been disclosed, and to ask them whether they could offer any guidance. Did HMRC, for instance, already have any view on such schemes or, more relevantly, was there some judicial authority to the effect that the Tenon scheme did not work? If the latter was so (as indeed, of course, it was), then the notional Inspector should have immediately concluded that he should assess the gross capital gains, and deny the claimed losses.

94. HMRC's counsel's answer was that the sub-section 29(5) test was quite straightforward. We had to answer the question of whether, on the basis of the "notional information" (all of it and no more) an HMRC officer of average competence (not an officer in a country district, or in central London or in a specialist section), would have concluded on his knowledge of the law (without referring to legislation, books, the Inspectors' Manual, and without seeking any guidance from colleagues) whether there was an actual under-assessment of tax revealed by the return. We referred in the hearing to the notion that the Inspector would thus be

addressing this question entirely on his own, in “a dark room”, and solely by reference to his assumed pre-existing knowledge of tax law.

95. Whilst the notional officer was deemed to have been aware of the existence of the SRN, and thus the feature that a tax avoidance scheme had been implemented, even if sub-section 29(6) deemed the officer to know that information (contained in an AAG1 form) would have been given to HMRC prior to the issue of the SRN, the taxpayers had not themselves provided the AAG1 information, and so the officer could not be expected to be aware of the content of the AAG1 document.

96. Even if the Respondents were wrong to say that the notional officer should not be taken to have knowledge of the content of the AAG1, it was then contended that even the awareness of the content of the AAG1, and the list of relevant section numbers on which the Tenon scheme had been based would still not have rendered the notional officer very much wiser. He would still have been out of his depth, in his “dark room” and without guidance from others would still not be aware of the actual insufficiency.

97. The notional officer might appreciate that a tax scheme had been effected, but he could only then be expected to conclude that “some tax schemes work and some do not”. Equipped with this conclusion he could not be said to be aware of “an actual insufficiency”. Accordingly it would follow that because the information in the return had not led the notional officer to conclude that there had been an actual insufficiency, the Appellants would not be able to block the sub-section 29(1) assessments, by relying on sub-section 29(5).

98. Accordingly, the Appeal ought to be dismissed.

Our Decision on the correct interpretation and application of sub-section 29(5)

99. Prior to addressing the facts of this case, and the crucial issue of whether we judge that the notional officer would have been aware of the insufficiency in the self-assessments, we will first address five general points in relation to the sub-section 29(5) tests.

100. These points are:

(a) Is there is a linkage between sub-section 29(5) and sub-section 29(1), such that the “situation mentioned in subsection (1) above”, referred to in sub-section (5), should be taken to refer not just to an “actual insufficiency” in the assessment, but to the sort of insufficiency that is addressed by sub-section (1), namely an insufficiency that a notional officer would have judged, on the information of which he was deemed to be aware at the end of the enquiry window, would justify the making of a discovery assessment and that would mean that such an assessment could and should be made?

(b) In the alternative, are the case law references, particularly those in *Veltema* to the effect that the return must disclose an “actual insufficiency”, and not merely the possibility that there might be an insufficiency, properly interpreted just to refer to the disclosure of factual information, or should they be taken more widely to refer to the return needing to reveal that there were actual and definite under assessments of tax? How would this interpretation be

consistent with the fact that it manifestly remains possible that valid discovery assessments can be overturned on appeal on the substantive issues involved, leading to the eventual conclusion that in the event, there was "no insufficiency"? Aside from this concern, would the taxpayer be expected to disclose in his return the feature of legal doubt as to the correct assessment, or should the returns indicate the actual fact of the returns being insufficient?

(c) As an expansion of the point in the previous paragraph, was HMRC right to contend that, in order for discovery to be precluded by sub-section 29(5), the actual return should specifically refer to the legal doubt about the appropriate law to apply in considering the correct assessments? Or is it sufficient just to provide an entirely accurate summary of the facts, and leave it to HMRC to apply whatever law they consider appropriate to those facts?

(d) Fourthly, and of fundamental importance in this case, we ask how the notional officer, aware of, and only aware of the information clearly attributed to him by sub-section 29(6), should be taken to consider the rights and wrongs of the self-assessment Do we treat the officer as having to consider this question, in his "dark room" without any reference to the law, books, Manuals and other guidance? Should we, in the alternative, treat the officer as proceeding in the way that we would have expected, and indeed in the way that HMRC themselves would have expected? That approach, on the present facts, would clearly extend to considering the law and to seeking specialist guidance in the way rendered obvious by the disclosure of the SRN number. Granted that deeming the officer to sit and worry in his dark room without guidance is indeed the last manner in which we would expect the officer to proceed, is this unrealistic state of affairs one that we are compelled to adopt by statute or by any authority?

(e) Finally, we ask the question that only arises if we feel compelled to apply the test in the previous paragraph in the manner that we self-evidently consider to be unrealistic, or which will be appropriate if the conclusion that we reach to the question in paragraph (d) above is wrong. Do we then have to conclude that if the officer is aware that the taxpayers have implemented a totally artificial tax avoidance scheme which the officer has insufficient legal knowledge to analyse, we must reach the rather limp conclusion that the officer would declare that "some schemes work and that others do not", so that the officer should do nothing? Would this be on the basis that if the officer was not "aware that **there was** an insufficiency, then even if the officer might have thought it appropriate to raise an assessment, the sub-section 29(5) test would not operate to shut out the discovery assessment, because the officer would **not have been aware of the actual insufficiency**. Or do we perhaps adopt a broadly equivalent "catch phrase" to the effect that "when assessments or protective assessments are made, some are eventually sustained, and some are not". If, then, there is every indication that the tax scheme is highly artificial, and that there must be some chance that, if attacked, the attack would succeed, the prudent course might be to make an assessment. We accept that in posing this final test, we are not postulating a very sensible test or choice for the officer, but this is simply because the

manifestly sensible test would have been held to be inappropriate in the light of the authorities.

The paragraph 100 (a) point

101. We consider that the reference in sub-section 29(5) to "the situation mentioned in sub-section (1) above" cannot possibly mean that the notional officer must be reasonably expected to be aware that there was a definite under-assessment. Sub-section 29(1) does not deal with the situations where under-assessments were certain as a legal matter. As already mentioned, it is perfectly possible for the Inspector's discovery assessment to be rejected on an appeal on the substantive points. The appropriate summary of sub-section 29(1) is that it permits an HMRC officer to make an assessment when for one reason or another he "newly comes to believe" that an earlier assessment has been insufficient. It is plain that the officer can make a discovery assessment once he concludes that he has a serious and justified case for making the assessment.

102. In the case of *Corbally-Stourton v. HMRC* (2008) SPc 00692, the Special Commissioner (Mr. Hellier) concluded that the right test was whether it was more likely than not that there had been an understatement that should rank as the relevant test. This test has been approved in some subsequent cases, though there has also been some criticism that there is no statutory or earlier case law authority for the test propounded.

103. We entirely agree with Mr. Hellier in relation to the fundamental point. The cross-reference in sub-section 29(5) back to the "situation mentioned in sub-section (1)" cannot be to the absolute certainty of an under-assessment, in part because that is never the situation addressed by sub-section 29(1), and in part because this approach fails to pay regard to the frame of mind of the actual officer making a discovery assessment under sub-section 29(1). In postulating what the notional officer should be aware of for the purposes of sub-section 29(5), it seems to us that the cross-reference back to sub-section 29(1) clearly refers to the frame of mind of the officer making a discovery assessment; in other words to the Inspector's new belief that there has been an under-assessment, and that a new assessment is now justified to rectify that, meaning that that new assessment has a reasonable chance of being sustained on appeal.

103. Whilst we agree with the fundamental point made by Mr. Hellier, we are inclined to put the actual test somewhat differently. Mr. Hellier put the test as one where we would have to judge that the notional officer would have concluded that an under-assessment was "more likely than not". The end result of the test that we consider to be the right test may not be far removed from that, but the logic of how we arrive at our summary leads us to say that the test provides for a slightly lower threshold.

104. Reverting to sub-section 29(1) itself, we do not believe that an officer, actually making a discovery assessment has to believe that the chances of sustaining that assessment on appeal, on the substantive points, are better than evens. Obviously it is right that the officer should not just make assessments on a whim or a suspicion (not least because in this context, the Inspector is always "on the back foot"). But we cannot see that the frame of mind on the part of the Inspector should demand anything higher than the way in which we have put it. On newly arriving at a belief that there has been an under-assessment, the officer should have a *bona fide* belief that a new assessment is justified, and that were it to be challenged on appeal on the

substantive points, there would be a reasonable prospect that the assessment would be sustained.

105. When we come to the test in sub-section 29(5) we are of course addressing a notional frame of mind, and one might be tempted to say that the "more likely than not test" that there had been an under-assessment makes sense. When however, we bear in mind the point (admittedly only a minor point, following the observations of Mr. Justice Henderson in *HMRC v. Household Estate Agents Ltd* [2007] EWHC 1684 (Ch)), that the burden of proof in relation to sub-section 29(5) is on HMRC to establish that the notional officer **would not have had** the relevant frame of mind, we do put the threshold test somewhat lower than Mr. Hellier. The test must be that HMRC must show that the notional officer, relying on all of, but no more than, the sub-section 29(6) information **would not have arrived at the belief**, at the end of the enquiry window, that there had been an under-assessment, and that in order to rectify matters **a new assessment was justified**, and that that assessment had a reasonable chance of being sustained. Since we believe that the Inspector does not have to meet any "more likely than not" standard, and that the burden is on HMRC to prove the negative, we put the threshold test lower for these two reasons.

106. While Mr. Avery-Jones CBE and Mr. Clark did not suggest that they disagreed with the test advanced by Mr. Hellier in making their own decision in *Derek Hankinson v. HMRC* [2009] UKFTT (TC), we believe that their approach was indeed slightly different and that it accords with the approach that we have just summarised. At paragraph 85 of that decision, they conclude that:

> *"we consider the relevant test to be that the officer must have evidential basis beyond mere suspicion in order to arrive honestly at the conclusion that, on balance, there is an insufficiency. The test is subjective, in that the officer must have satisfied himself that this is the appropriate conclusion"*

The paragraph 100 (b) point

107. We consider that where the authorities refer to the need for the return to clarify that there was an actual under-assessment, and not merely that there might have been an under-assessment, all these cases are referring to the production of inadequate facts. This is generally made clear by the fact that not only are the authorities then dealing with doubtful facts, but they generally contrast the summary of what is required in the factual information with the particular doubtful feature in the facts given.

108. In *Veltema* the return gave no indication of what asset had been transferred, what it was worth and whether it might have been worth more than £100,000. Whilst there are a number of references in Lord Justice Auld's judgment to the requirement that the return must disclose that there was an actual insufficiency disclosed by the return, it was abundantly clear that all these references referred to the fact that it was the inadequate information that occasioned the doubt as to whether there was in fact an under-assessment. The whole feature that the case revolved around the interpretation of sub-section 29(6) and the feature that that subsection refers only to the factual information deemed to be available to the notional officer in considering the sub-section 29(5) test makes this absolutely plain.

109 It was again the case in *HMRC v. Household Estate Agents Ltd* that the feature in that case, involving contributions by a company into an employee benefit trust, that undermined the company's claim to protection from a discovery assessment

under section 29(5), was that the disclosed facts did not reveal a definite insufficiency. The Corporation Tax deduction was only denied if the trust had not passed on the contribution within 9 months such that the contribution was then included as an employee's income. Whilst it was unlikely, in common sense terms, as he held, that the trust would have so passed the contribution out to employees within the 9-month period, Mr. Justice Henderson considered that it was that feature of theoretical doubt about that factual matter that precluded the conclusion that there had been a disclosure of "an actual insufficiency".

110. We also observed from discussions during the hearing that very little sense could be made of the alternative contention that the "actual insufficiency" had to refer not to the summary of facts but to the legal outcome.

111. We will deal, in addressing the "paragraph 100 (c)" point below, with the cases where we consider that it is essential for the return specifically to flag points of doubt in relation to the law. For present purposes, we note that if the return merely referred to doubt as to the proper application of the law, disclosure of this doubt would achieve nothing, since on HMRC's answer to the question posed at paragraph 100 (d), the bewildered HMRC officer in his dark room would be no nearer to appreciating that there was an "actual insufficiency". And one could hardly confine protection under sub-section 29(5) to the case where taxpayers inserted a statement that the return "was insufficient", particularly because, as in this case, the taxpayers would often believe that the return was correct. And, it cannot be right that the return would inevitably reveal an actual insufficiency as a legal matter.

112. It seems to us to be clear that it is the factual information, as regards which there must be clear disclosure in the assessments, in respect of which HMRC must then demonstrate the situation summarised at the end of paragraph 105 above.

The paragraph 100 (c) point

113. It has been contended in submissions in some of the relevant recent cases that protection under sub-section 29(5) is dependent on the terms of the return actually flagging the law, or uncertainty about the law, or perceived differences in the view of the law between the taxpayers and HMRC, before the protection of sub-section 29(5) will be available. No authority that is binding on us has treated this as an implicit requirement of sub-section 29(5), and we conclude that such further disclosures may be required on some facts, whilst being unnecessary in other situations.

114. Taking the facts of *Veltema*, where an employment benefit had been declared at £100,000, it must be self-evident that if the return had in fact also indicated (something that on the actual facts had not been identified until later) that the relevant house had been treated as disposed of by the company for Corporation Tax purposes for £145,000, and that the director had paid nothing for the house, it would have become instantly obvious that the self-assessment return by the individual revealed an under-assessment. If these facts had been revealed, but no statement had been inserted into the return to draw attention to the fact that the declared employee benefit might have been, or was bound to be, under-stated, we cannot think that in so obvious a case, the absence of those further disclosures would have been of the slightest significance.

115. At the other end of the spectrum, there may very well be cases where to derive the protection of sub-section 29(5) the taxpayer would need to refer to the basis on which he had made his self-assessment, and it might indeed be necessary to go further

and disclose that, whether or not HMRC's approach to the law was known, other views were also tenable. The situation that we have in mind here is that where there are complex issues of tax law involved, having nothing whatever to do with outright and obvious avoidance, and thus notably where the average HMRC officer, or indeed even the "distinctly above average" officer might have no idea that some features of the return might justify adjustments. In his own interests, if the taxpayer in that sort of situation wishes to achieve "finality" it might very well be prudent, and indeed necessary, to flag areas that any officer might very easily miss, without any discredit.

116. The facts in this case are different. In this intermediate case (between those considered in paragraphs 114 and 115), no officer could have missed the point that an artificial tax avoidance scheme had been implemented. That needed no further clarification. Whether the notional officer would then have been reasonably expected to be aware of the law, and whether he should or could seek guidance from colleagues we will deal with under the next question. What is just glaringly obvious in contrast to the one that we mentioned in paragraph 115, is that no HMRC officer could have missed the point that the taxpayers had effected an avoidance scheme. On that information, the possibility of challenge cannot have escaped anybody's attention.

The paragraph 100 (d) point

117. The question posed at paragraph (d) of paragraph 100 above seems to us to be the most critical question in this case.

118. We first observe that the reason why an enquiry was not opened in relation to the tax returns of the three Appellants was not because any Inspector looked at the returns and missed points, but was due to administrative slip-ups, such that no-one of the appropriate seniority would have even looked at the three returns. HMRC admitted that there had been such slip-ups.

119. Anticipating the findings of fact that we are going to reach, we are going to conclude that:

- it was absolutely obvious from the information given in the white spaces of the returns, that the three Appellants had participated in artificial tax avoidance schemes to generate capital losses; and
- the disclosure of the SRN reference number for the scheme, and the fact that the scheme had been implemented in the then current tax year, not only reinforced the point that the transactions were effected as part of a marketed tax avoidance scheme, but they also indicated that full disclosure would have been made to HMRC specialists of the workings of the scheme. From this information, it would have been obvious to any officer that those officers receiving the DOTAS disclosures in the AAG1 would have considered the scheme with those in HMRC responsible for the specialist areas in question, and a view would already have been reached as to whether (i) the scheme might be challenged successfully under existing law; or (ii) whether a change in legislation was required, or (iii) whether the planning was considered reasonably acceptable such that neither (i) nor (ii) was appropriate.

120. We have already suggested, in paragraph 115 above, that where the notional officer, or even the distinctly above average officer, might well **not** have been expected to perceive doubtful matters of tax law in relation to the type of situation canvassed in that paragraph, it would not be appropriate to expect the officer to

question the return unless doubt was expressly drawn to the officer's attention in the return. Absent such a "flag" in the return, the officer could also not be assumed to have sought guidance from others into a matter that anyone could have missed. The fact that remote specialists within HMRC might have readily appreciated that the legal basis, on which the self-assessments had been submitted, were challengeable would be completely irrelevant. Thus in that situation, sub-section 29(5) protection might only be secured if the points were aired or flagged in some way by the return.

121. Where, however, as in this case, no officer could conceivably have missed the points made by the bullet points in paragraph 119 above, it is inevitably the case that the officer would either have considered the law himself or, more appropriately still in the light of seeing he SRN reference number, he would have sought guidance from specialist colleagues, who he would have known would have considered the scheme in depth. And he would consider their views before deciding whether or not assessments were justified.

122. We consider that the ban on raising further enquiries about the facts, implicit in the Court of Appeal's decision in *Veltema*, and indeed in sub-section 29(6), has no bearing on how we should expect the notional officer to approach his proper task of then considering the information and deciding whether or not he should raise assessments. And if it is glaringly obvious either that the relevant officer should consider the law, and possibly refer to published material or, where an SRN number is disclosed, simply send an e-mail or make a phone call to colleagues and ask for guidance, this is precisely how we should treat the notional officer as proceeding.

123. This approach does not fall into the error of attributing to the "notional average officer" the views and knowledge of specialists as such. It only has this effect in those cases where any officer would inevitably seek guidance, and indeed know precisely where to seek that guidance. It simply deems the notional average officer to approach matters realistically, as HMRC would inevitably expect him to operate, and it avoids the absurdity of consigning the officer to his dark room, without legislation, books or other information, and with no opportunity to seek guidance from colleagues.

124. The above approach would have no bearing on the simple case where we would postulate the notional average officer taking his own decision on whether to assess. It simply suggests that one just considers what the notional officer should and would have done in the relevant circumstances. It thus deals perfectly sensibly with the very simple cases, the distinct type of situation referred to in paragraph 115 above, and the manifestly obvious tax avoidance scheme that has already been disclosed to, and reviewed by, HMRC in this case. It deals with each in the appropriate way, and it avoids the consequence of HMRC's contention and acceptance that the test is crafted essentially for the simple scheme, and thus regrettably fails to work sensibly in a case such as the present case.

125. We are considering the proper application of subsection 29(5) in this case, and the issue of whether the test creates the right balance of fairness between HMRC and the taxpayer is entirely secondary. If we were to adopt the contentions and conclusions advanced in this case by HMRC, we cannot resist observing that a quite extraordinary imbalance would have been achieved between the taxpayer and HMRC. In this case the taxpayer has disclosed, with perfect accuracy, the essential features of the scheme, such that we understood immediately precisely what was involved. The notional officer might have been slightly slower in reaching such a conclusion, but could not have doubted that a very artificial scheme had been implemented.

Equally clearly that scheme had been disclosed to HMRC under the DOTAS rules. When the taxpayer has given information that reveals these facts, it would be extraordinary if the protection of subsection 29(5) was not to apply, when one remembers that:

- first, HMRC would have utterly failed to look at the return, and to open the enquiry that should obviously have been opened;
- and secondly, the notional officer deemed to be considering the disclosed information, could be treated as unable to access any information about the law, any guidance in text books and the Inspectors' Manual, and precluded even from making the one glaringly obvious phone call that would have instantly revealed that HMRC had undermined the relevant schemes, and succeeded both before the Special Commissioner and the High Court in sustaining that challenge.

The paragraph 100 (e) point.

126. On our view of the proper application of the sub-section 29(5), the question posed at paragraph (e) of paragraph 100 above does not arise, but if we were wrong in the application of the sub-section 29(5) test that we have summarised above, we are still not entirely sure why the notional officer should be assumed, in his dark room, without guidance, law, Manuals or other published information, simply to dither, and then fail to assess because "some tax avoidance schemes fail and others do not". It seems, even on this seemingly ridiculous hypothesis, that the notional officer might more sensibly take the view that he should make an assessment, charging the gross gains and disallowing the losses, under the alternative expression, that "some assessments are sustained on appeal, and others are not". Equipped with the knowledge that many schemes, which taxpayers' counsel and advisors consider to be effective, actually fail, there might well be justification for making an assessment.

127. We accept that the notional officer should not be considered to be justified in making an assessment on just a whim or a suspicion. Taking the facts of this case, however, the officer might still be proceeding on much more than a whim. We repeat that we ourselves have no idea of the basis of the decisions at the three relevant levels in the *Drummond* case. We have refrained from opening any of the reports. In terms of judging whether the notional officer might have a legitimate justification for making an assessment, we note that:

- he would be aware that the capital loss derived from the exclusion in the capital gains legislation of something that had been taken into account as income for income tax purposes; and
- he would have been aware that no income had been returned in respect of the policy.

On those basic facts, we consider that any officer might legitimately take the view that a Tribunal or court might well decide that something should only rank as having been taken into account for income tax purposes when in reality that treatment had in the event been demonstrated, rather than reversed. Whether that was the basis of the various actual decisions in *Drummond* we do not know, but had the officer considered the facts and information that he had in the "dark room", we consider that he could and should have assessed on this basis. He should not simply have dithered, and remarked that "some schemes work and others do not".

The application of the principles summarised above to the facts of this case

128. It is perfectly obvious in the case of the returns of at least two of the Appellants that nobody even looked at the returns. Had they done so, enquiries would have been opened.

129. In applying the test in sub-section 29(5), the notional officer is deemed to be aware that:

- the taxpayers realised capital losses in amounts roughly equivalent to the gains that they realised on the disposal of quoted investments, and indeed in significant amounts;
- those losses derived from transactions in insurance policies that were held for very short periods, not seemingly consistently with the two most obvious situations in which insurance policies might be taken out and held;
- the transactions in relation to the insurance policies oddly occasioned small actual losses, but were also treated, very much more surprisingly, as occasioning very large capital losses for tax purposes, in a figure greatly in excess of the actual small losses;
- the losses were said to derive from the fact that the amount received on the partial surrenders of the policies had been taken into account for the purposes of income tax, notwithstanding that no income had been declared as deriving from the policies; and
- as we noted in paragraph 25 and 26 above, the text in the tax return had not been confined to summarising facts, but had given a sufficient indication of the tax thinking underlying the transactions for us at least to realise instantly precisely how it was thought that the scheme worked for tax purposes.

130. No HMRC officer could learn of those facts without it being instantly obvious that a tax avoidance scheme had been implemented.

131. Aside from the conclusion just reached, the further disclosure that the taxpayers had implemented a disclosed avoidance scheme, whose SRN reference number had also been disclosed, both reinforced the obvious conclusion in paragraph 130 above and revealed that some of the notional officer's colleagues (who could easily be identified within HMRC) had already considered the detail of the scheme implemented.

132. Were we right to say, in dealing with our approach to the question posed at paragraph (d) of paragraph 100 above, that the officer should then have proceeded to seek some guidance from colleagues, precisely as he would have done in the real world, and indeed as HMRC would have insisted that he proceed, he would have been informed at the point the enquiry window closed that the High Court had affirmed Sir Stephen Oliver's decision in *Drummond,* that that undermined the Tenon scheme implemented by the three Appellants, and that immediate assessments should be made.

133. Were we wrong in saying that the notional officer should be "reasonably expected" to reach conclusions that we would "inevitably expect him to reach if he proceeded as we inevitably would have expected him to proceed", then for the reasons given in paragraph 127 above, we still consider that at the end of the enquiry window the officer could and should have raised discovery assessments because he had adequate genuine grounds for disallowing the losses. We consider that on that

alternative basis, HMRC would still be shut out from making the discovery assessments that it has sought to justify.

Final conclusion

134. Our conclusion is accordingly that although we endorse the views of HMRC in relation to the proper interpretation of sub-section 29(1), and the respect in which it is only the conflict with the provisions dealing with matters already settled by final determinations of the courts or section 54 agreements, that cuts down the wide power to make discovery assessments, the taxpayers in this case are protected from the making of discovery assessments, by sub-section 29(5).

135. Accordingly the three Appeals are allowed.

The information in the AAG1 disclosure

136. This point is not of relevance to our decision, but we agree with HMRC that the mere fact that the notional officer is to be treated by sub-section 29(6) as being aware that, once an SRN had been allocated to a particular scheme, an AAG1 form, with relevant scheme information on it, must exist, does not mean that the notional officer must be treated as being aware of the content of that information.

137. We are also inclined to agree with HMRC that, if the right approach to considering how the notional officer was required to proceed, that we dealt with in relation to paragraph 100 (d) above, was as we suggested, then the notional officer would be very unlikely himself to have scrutinised the disclosed section references, had he been aware of them. He would have proceeded as we suggested. And even more obviously, if we were wrong in our answer to the question posed by paragraph 100 (d) above, and the officer was meant to be fretting in his dark room, without the ability even to refer to the sections to which he would have been directed by the AAG1 information, he would obviously have been "none the wiser".

138. Accordingly we consider that at least in this case, the availability of the actual information on the AAG1 form would have been of little practical relevance.

Right of Appeal

139. This document contains full findings of fact and the reasons for our decision. Any party dissatisfied with this decision 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)

Released: 13 July 2011