[2016] UKFTT 0375 (TC)

TC05129

Appeal number: TC/2015/05871

INCOME TAX – discovery assessment – whether trust tax return 'information made available' to hypothetical officer considering appellant's tax return – no – whether hypothetical HMRC officer 'aware' of insufficiency from information made available – no – whether discovery stale – obiter comment from* Charlton *not followed - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

SIMON MIESEGAES **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE Barbara Mosedale
Michael Sharp

Sitting in public at the Royal Courts of Justice, London on 9 & 10 May 2016

Mr D Ewart QC for the Appellant

Mr J Henderson, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. In his tax return for tax year 2006-7, the appellant declared his income received in his capacity as life tenant of a trust and claimed 100% tax relief on it under the UK-Guernsey double tax treaty. The appellant now accepts that he was not entitled to the claimed tax relief for which he has been assessed. He appealed the assessment, nevertheless, on the grounds that it was procedurally incorrect.

2. HMRC accepted that it was for them to show that they made a procedurally valid assessment. For that reason, they opened the hearing.

Facts

3. The facts concerning the arrangements into which the appellant entered and the contents of the tax returns submitted were not in dispute and in so far as relevant we set them out below. What was in dispute was whether and when HMRC had made a discovery: we will deal with our findings of fact on that in the last section at §§114-128.

4. The appellant was a UK taxpayer. In the tax year 2006/7, he established a trust, the Simon Victor Miesegaes Charles Street Settlement ('the Settlement') with capital of about £1,000. He was the life tenant of Settlement. The trustee of the settlement was Terravale Investments Limited ('the Trustee'). The Trustee was a Guernsey registered and resident company.

5. On 1 November 2006, the appellant completed form 41G (Trust) for the Settlement and submitted this to his local tax office (as advised by HMRC). The form notified HMRC of the existence of the Settlement, that the appellant was its settlor by virtue of a cash payment of £1,075, that the trust was governed by the laws of a country outside the UK and that its general administration was carried on outside the UK.

6. The Trustee, in its capacity as trustee, entered into a Guernsey limited partnership with other trustees ('the Partnership'). The Partnership traded in property in the UK in the tax year 2006-7 and made a profit. The appellant was entitled to and received, as life tenant, the Settlement's share of the profit in the same tax year.

7. The appellant's tax return for 2006-7 was submitted on 11 September 2007. As we have said, the appellant declared his income as life tenant of the Settlement on this tax return. He declared this on the "foreign" additional pages of tax return in the section for "income received by an overseas trust, company, and other entity (excluding dividends)" by handwriting as follows:

Income from life tenancy of Simon James Victor Miesegaes Charles Street Settlement	£755,573
	(£755,573)
Less exempt under Article 3 of UK/Guernsey Double Taxation Treaty	£0

8. There were no other relevant entries on his tax return other than in the 'additional information' white space box on the foreign income additional pages where he wrote in hand:

> 'Form 41G (Trust) sent in 1/11/06 re settlement of £1,000 in Simon James Victor Miesegaes Charles St Settlement.'

There were various additional pages sent in accompanying the tax return. None were relevant to this income other than a single line on the tax calculation page where it said: "Foreign Income (DTR)' against which £0 was entered. His covering letter, sent with his tax return, referred amongst other matters to the fact he had completed the foreign income section in respect of the Settlement notified to HMRC.

9. The Trustee also completed a tax return for 2006-7 ('the trust tax return'). This was sent, as it should have been, to HMRC's Centre for Non Residents in Nottingham. It was dated 29 January 2008 and contained a large white space disclosure. HMRC accept that so far as this appeal is concerned, that disclosure, had it been contained in the appellant's tax return, was sufficient to reveal to HMRC that the appellant had claimed a relief in his tax return to which he was not entitled. It included, in particular, the information that the Settlement had traded in partnership.

10. The appellant amended his 2006-7 tax return by letter to HMRC on 11 August 2008. This had two bullet points. The first read:

> A scheme reference number should have been completed in box 23.5, which number is 42081971 and in respect of box 23.6, this should have the year 2012.

11. Question 23 of the tax return form required the taxpayer to complete boxes 23.5 and 23.6 if he was party to a disclosable (ie DOTAS) tax avoidance scheme. The appellant had originally left this blank. Box 23.5 required the DOTAS scheme reference number ('SRN'): the SRN which the appellant gave in his 11/8/8 amendment letter was the SRN for an arrangement, which, while very similar to the one he undertook, involved settlements established in the Isle of Man. Box 23.6 required the tax payer to state the 'tax year in which the expected advantage arises' and, as we have said, the appellant stated 2012.

12. The second bullet point related to declaring income which should have been declared in the 2006-7 return: this was income of £21,293 which was stated to arise as a result of his life interest in the Settlement. The appellant recognised his liability to tax on this and enclosed a cheque for the amount he calculated as underpaid.

13. We find, to the extent that it was in dispute, that there was nothing in this letter which linked the income disclosed in the second bullet point to the scheme disclosed by the first: moreover, there was nothing which linked the disclosed scheme and its SRN to any entries already made on his tax return for that year. In particular, the disclosed scheme related to trusts established in the Isle of Man and not Guernsey, and the appellant had said the tax advantage was expected in 2012 and made no reference to a tax advantage having already arisen in 2006-7 (in that in that return he had already claimed 100% relief on his trust income on his tax return for that year). Indeed, it appears to us for these reasons that the first bullet point disclosure related to a different scheme to the one which gave rise to the assessment at issue in this appeal.

14. We note in passing that HMRC accept that the arrangements which were the subject of this appeal were not arrangements relating to a disclosable scheme with a SRN. HMRC refer to the appellant's arrangements as a tax avoidance scheme: the appellant objects to the use of this terminology. We do not need to decide whether it was proper to refer to the arrangements the subject of this appeal as a tax avoidance scheme as it is not relevant to what we are called to decide.

15. No notice of enquiry was ever given by HMRC to the appellant in respect of his 2006-7 return. But the appellant was assessed to additional tax of £311,729.93 on 18 March 2011 when a Mrs Coulthard raised a discovery assessment. The assessment was issued with a short letter implying that the assessment was raised because of the appellant's claim for relief arising under the Isle of Man/UK double tax treaty which by retrospective legislation was 'beyond doubt' invalid. A few days later, on 22 March 2011, Mrs Coulthard wrote a further letter stating that there was an error in the earlier letter, as it should have referred to the Guernsey/UK double tax treaty, but that this did not affect the assessment.

The law on discovery assessments

16. The assessment under appeal was raised under s 29 Taxes Management Act 1970 (' TMA'). This provided as follows:

> (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, … have not been assessed, or
>
> (b) that assessment to tax is or has become insufficient, or
>
> (c) [not relevant]
>
> 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.
>
> (2) [not relevant]
>
> (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.

(4) the first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.

(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 taxpayers return under section 8 or 8 A of this Act in respect of the relevant year of assessment; or

(b) informed the taxpayer that 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.

(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 taxpayers return under section 8 or 8 Of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements and documents accompanying 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.

(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 2 immediately preceding chargeable periods; 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 include a reference to a person acting on his behalf.

17. As we have said, HMRC accepted that they had the burden of proof of proving a valid, in-time discovery assessment.

The Dispute

18. In brief, to make a valid discovery assessment HMRC must show that either conditions 29(5) or 29(4) were met. HMRC do not claim that the condition in s 29(4) was met, so submissions concerned s 29(5). Submissions at the hearing concerned three matters of dispute:

> (1) the appellant's primary case was that the discovery assessment was unlawful because it failed to meet the condition in s 29(5) as, under s 29 (6)(d)(i), the information in the white space of the trust tax return was information the existence of which and the relevance of which should, says the appellant, have been inferred at a date before the enquiry window into the appellant's tax return closed;
>
> (2) and, in any event, said the appellant, the information contained on the appellant's own tax return meant that HMRC should have been aware of the insufficiency at the time the enquiry window closed;
>
> (3) and, lastly says the appellant, HMRC did not make a discovery within s 29(1) or at least, if they did, failed to act on it promptly.

First issue – the trust tax return

The s 29(5) condition

19. Section 29(5) required HMRC to show that, at the time the enquiry window closed (s 29(5)(a)), an officer could not have been reasonably expected to be aware of the 'situation mentioned in subsection (1)' on the basis of certain information. So we need to determine:

> (a) The date at which the enquiry window closed;
>
> (b) What was the situation mentioned in subsection (1);
>
> (c) The information made available to the officer;
>
> (d) Whether, taking into account this information, this hypothetical officer could not have reasonably be expected to be aware of the situation at that date

(a) Date at which enquiry window closed

20. At the time, TMA s 9A(2)(a) provided that where a return was filed on or before the due date, the enquiry window closed 'twelve months after the filing date'. So, as the parties agreed, the enquiry window closed on 1 February 2009, which was 12 months after the due date for filing of 31 January 2008, and irrespective of the actual filing date of 11 September 2007. So the date at which the Tribunal must assess what an hypothetical HMRC officer ought to have been aware of is 1 February 2009. At that date the Settlement's tax return had also been submitted.

21. There is one caveat and that is that the appellant amended his return on 11 August 2008. This was within the twelve months permitted by s 9ZA TMA. The effect of the amendment and S 9A(2)(c) TMA was to extend the enquiry window to 31 October

2009 but only in relation to anything in the return 'to which the amendment relates or which are affected by the amendment'.

22. HMRC's case was that there was nothing in the claim for double tax relief made in the return which was related to or affected by the amendments. The appellant made no reply to this and therefore either accepted HMRC's case on this or considered it irrelevant in that there was no suggestion that HMRC acquired additional information between 1 February 2009 and 31 October 2009.

23. In so far as this actually needs to be decided, we find that the enquiry window in relation to the Guernsey/UK double tax treaty relief claim shown on the appellant's tax return closed on 1 February 2009. There was nothing in the amendment which related to it or affected it (§§10-13). The first bullet point disclosed a SRN for an Isle of Man/UK double tax treaty tax avoidance scheme with the benefit expected to arise in 2012. This seems to have been an entirely separate scheme to the arrangements in issue in this appeal: certainly there was nothing to relate the information in the amendment to a claim for relief in 2006-7 under the Guernsey/UK double tax treaty tax. The second bullet point did relate to income from the Settlement at issue in this appeal but said nothing about the claim to relief under the double tax treaty made in the return. Indeed, the amendment did not claim relief but admitted liability to tax on income of about £21,000. Therefore, the amendment did not extend the enquiry window so far as the matter for which HMRC raised a discovery assessment is concerned. But the point seems irrelevant to us as the information to be treated as available to HMRC seemed to be the same on 1 February and 31 October 2009.

(b) What was the situation mentioned in subsection (1)?

24. The situation is that (s29(1)(a)) 'income which ought to have been assessed to income tax has not been assessed' or (s29(1)(b)) 'an assessment to tax is …insufficient'. It is accepted by the appellant that his self-assessment was insufficient under s 29(1)(b) as it failed to assess tax on the appellant's income from the Settlement; that also means that income which ought to have been assessed to income tax was not assessed under s29(1)(a). So it was caught by both 29(1)(a) and (b): this failure to self-assess the life tenancy income was referred to in the hearing as 'the insufficiency' and we will adopt that shorthand in this decision notice.

(d) Awareness of the situation

25. The primary dispute centred on what information was 'made available' to the hypothetical HMRC officer and in particular whether the trust tax return was information made available to HMRC. So far as the awareness of the hypothetical officer was concerned, HMRC conceded that ***if*** the contents of the trust tax return was information made available to the hypothetical officer under s 29(5), then (so far as this appeal was concerned) he ought reasonably to have been aware of the insufficiency. So the primary dispute was whether the effect of s 29(6) was to treat the hypothetical officer as having the trust tax return made available to him.

(c) Information made available under s 29(6)

26. It was also assumed by both counsel that the hypothetical HMRC officer must be assumed to have the taxpayer's tax return in front of him. And that is, we think, right. Any actual or hypothetical officer considering the trust tax return when it was filed could not, from the contents of the trust tax return, have known of the insufficiency on the appellant's tax return. He would not know whether the income shown on the trust tax return was assessed to tax by the appellant on his own return. So the question is whether a hypothetical officer, hypothetically considering the appellant's actual return just before the enquiry window closed, ought to be taken to have made available to him the white space disclosure in the trust tax return.

27. So we look at the question through the eyes of an hypothetical HMRC officer considering the appellant's 06/07 tax return just before the closure of the enquiry window on 1 February 2009 and whether that officer ought to be taken to know the contents of the white space disclosure on the trust tax return.

28. What information was made available was defined in s 29(6) TMA. S 29(6) is exhaustive. If the information was not within 29(6) then it was not made available. Broadly, s 29(6)(a)-(c) concerns information provided to HMRC directly by the taxpayer; s 29(6)(d) deems certain other information to be known to the hypothetical HMRC officer. S29(6)(d)(i) provides protection to a taxpayer as it effectively prevents a discovery assessment based on certain information. But s 29(6)(d)(i) is restrictively drawn:

(1) Firstly, the officer is inferred to know about only 'information'.

(2) Secondly, the inference must arise from other information, being information within s 29(6)(a)-(c)

(3) The inference must be that the information exists;

(4) The inference must also be that the information is relevant to the insufficiency;

(5) It must be reasonable to expect the hypothetical officer to make the inference about this other information.

29. Information: S29(6)(d)(i) does not treat the contents of documents as made available just because the documents are available to HMRC officers. So here there is a distinction between the trust tax return and the information contained within it, in particular the white space disclosure referred to at §9 above. We do not think a tax return can be regarded as 'information': it is the contents of a tax return which amounts to information. This is borne out by the structure of s 29 which refers to information 'contained' in a return. Even if the hypothetical officer could have inferred that the trust tax return existed, that does not mean in our view that he should be treated as having made available to him the contents of the trust tax return.

30. In other words, the question is whether the white space disclosure, which was information contained within the trust tax return, was information 'the existence of which and the relevance of which as regards' the insufficiency could reasonably be expected to be inferred by an officer of HMRC.

31. Inference from information within (a)-(c)? Both parties were agreed that (b) and (c) of s 29(6) were not relevant here: there was no reference to the trust tax return or the white space disclosure in it in any claims made, or documents submitted, by the taxpayer. We are only concerned with s 29(6)(a) here and the appellant's own tax return.

32. That tax return made no mention of the trust tax return. The appellant's case is that the existence of the trust tax return could reasonably be expected to be inferred, however, because the appellant mentioned the trust, the trust income and the form 41G (trusts) (see §7-8) in his tax return. It would be a reasonable inference that the Settlement would make a return, said the appellant, and that that return would contain information relevant to the entry on the taxpayer's return about the income from the trust.

33. So the appellant's case relied on the reference to the trust, the trust income, and the form 41G (trusts) in his return. Should an officer reasonably be expected to infer from this that the white space disclosure in the trust tax return existed and was relevant to the insufficiency?

34. Reasonable to infer existence and relevance? We do not accept that a hypothetical HMRC officer could infer from the appellant's tax return any more information than that (1) there was a trust known to HMRC of which the appellant was life tenant and had received substantial income, and (2) that that trust might have made a timely tax return to year end 31 January 2007 and that (3) that tax return might contain information which might explain the appellant's claim to relief under the double tax treaty made on his return.

35. The appellant thought these inferences sufficient to fix HMRC with knowledge of the white space disclosure. We do not agree. As a matter of literal interpretation of s 29(6)(d), the hypothetical officer was only fixed with knowledge of information if he reasonably ought to have inferred the existence and relevance of the information to the insufficiency: not merely that he ought to have inferred the information possibly existed and possibly would be relevant. To be fixed with knowledge of it, he must have been in the position that he ought reasonably to have inferred the information did exist and was relevant.

36. *Charlton – the law:* What s 29(6)(d)(i) meant was considered in the Upper Tribunal decision in *Charlton* [2013] STC 866. Both parties relied on what the Upper Tribunal said at [78-79]:

> "[78] The correct construction of s 29(6)(d)(i) is that it is not necessary that the hypothetical officer should be able to infer the information; an inference of the existence and relevance of the information is all that is necessary. However, the apparent breadth of the provision is cut down by the need, firstly, for any inference to be reasonably drawn; secondly that the inference of relevant has to be related to the insufficiency of tax, and cannot be a general inference of something that might, or might not, shed light upon the taxpayer's affairs; and thirdly, the inference can be drawn only from the return etc provided by the taxpayer.

> [79] As we have described, the balance provided by s 29 depends on protection being provided only to those taxpayers who make honest, complete and timely disclosure. That balance would be upset by construing s 29(6)(d)(i) too widely. Inference is not a substitute for disclosure….."

37. Applying that test to the facts of this case, the fact the hypothetical officer could have inferred that a trust tax return might exist and might contain something relevant to the entries in the appellant's tax return is not sufficient to fix HMRC with knowledge of the white space disclosure in the trust tax return.

38. *Charlton – the facts:* In that case the taxpayers entered into complicated tax avoidance scheme involving the purchase and partial surrender of life insurance policies. The taxpayers' tax returns disclosed the SRN for the relevant scheme and a brief outline of what had been done but otherwise did not draw the attention of HMRC to the insufficiency.

39. To obtain a SRN the promoter of any scheme had to complete and file with HMRC a form AAG1 and an HMRC officer ought to have known this. The AAG1 explained how the tax scheme worked and the interpretation of the legislation it relied on to be effective. The Upper Tribunal concluded, therefore, that the hypothetical officer ought to have inferred from the SRN the existence and relevance of the form AAG1to the insufficiency and was therefore was fixed with knowledge of the contents of the AAG1 and the contents meant HMRC was fixed with knowledge of the insufficiency when the enquiry window closed.

40. On the one hand, the Upper Tribunal said at paragraph [75] that S 29 (6)(d)(i) did not have the consequence of

> "enabling any document that could reasonably be assumed to exist effectively to be treated as if it were before the hypothetical officer"

but on the other hand at [76] they said S 29 (6)(d)(i) did not require the hypothetical officer to be able to infer from the tax return the information contained in the document in question. The effect of S 29 (6)(d)(i) was said in [80] that the hypothetical officer will only be fixed with knowledge of contents of a document not referred to by the taxpayer in his tax return (or other documents in S 29 (6)(b)-(c)) where that tax return (or other information) meant he ought reasonably to infer that the document existed and its content would be relevant to an insufficiency in the tax return.

41. In that case that meant the officer was fixed with knowledge of the contents of the AAG1. The law (set out in [84] of the decision) required the AAG1 to contain enough information for an HMRC officer to understand the scheme and indeed it seems that unless it did so, HMRC could reject it. So the SRN on the tax return indicated that the AAG1 both existed and would contain enough information from which the scheme could be understood.

42. Considering other cases, in the FTT case of *Trustees of the Bessie Taube Discretionary Settlement Trust and others* [2010] UKFTT 473 (TC), two trusts received a special dividend from companies in which they held shares. They

(wrongly) treated it as repayment of capital and not as a receipt of income and completed their tax returns accordingly. In other words, the returns made no mention of the special dividend. In the circumstances, HMRC were held entitled to make a discovery assessment because there was nothing in the information provided by the taxpayer which could have alerted them to the payment of the special dividend.

43. And in the earlier Court of Appeal decision in the case of *Langham v Veltema* [2004] STC 544 CA the hypothetical officer was not fixed with notice that a value given on the tax return was an undervalue in circumstances where he ought to have known another department of HMRC might have investigated the valuation. He was not required to ask that department for any valuation they may have undertaken. So HMRC were allowed to raise a discovery assessment: the asset was shown at an undervalue on the tax return (albeit apparently unknown to the taxpayer at the time). There was nothing on the face of the tax return which would have alerted the hypothetical officer to the fact it was an undervalue.

44. In this case, however, even if the existence of the trust tax return ought to have been inferred, there was nothing in the appellant's tax return which suggested that the trust tax return would have an explanation of the entries on the taxpayer's return. The weakness in the appellant's case is that even if it was a reasonable inference that the Settlement would have submitted a tax return, there was nothing in the appellant's tax return from which the hypothetical officer should reasonably have inferred the existence of the white space disclosure made in the trust tax return.

45. *Purpose of the tax return:* Mr Ewart's answer to this was that that the purpose of the trust tax return was to establish the beneficiaries' tax liability and therefore, he said, it was reasonable to suppose that it would do so. S 8A TMA provides:

> "For the purpose of establishing the amounts in which the relevant trustees of a settlement, and the settlors and beneficiaries, are chargeable to income tax and capital gains tax for a year of assessment…an officer of the Board may...require the trustee [to file a tax return]"….

46. We do not see how this helps the appellant. S8 TMA (for personal tax returns) has much the same preamble:

> "For the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment…he may be required by a notice given by an officer of the Board [to file a tax return]…."

47. While the purpose of the personal and trustee tax return is clearly to ascertain a taxpayer's tax liability, it is for the taxpayers to assess their own liability. Unlike with the form AAG1, HMRC have no say in how much information a taxpayer chooses to put on his return and how complete any disclosure he makes is. So while it is virtually certain an AAG1, which has been accepted by HMRC and awarded a SRN, would fully explain the scheme, it is only a possibility that any particular tax return would fully or even partially explain any insufficiency. And where a taxpayer in his own tax return, for whatever reason, chose not to disclose an insufficiency relating to his trust income, we see no reason why a hypothetical officer ought to suppose that the trustee would chose to disclose it, and that is all the more so when there was nothing in the

taxpayer's return to indicate that there would be relevant material in the trust tax return.

48. The question is whether it was reasonable for a hypothetical officer to infer, from the entries on the appellant's tax return, the existence and relevance of the white space disclosure on the trust tax return. There was simply nothing in the appellant's tax return that in any way indicated that there would be relevant material in the trust tax return and it cannot be said it was reasonable for a hypothetical officer to infer, from the entries on the appellant's tax return, the existence and relevance of the white space disclosure on the trust tax return. It would have been mere speculation on the part of the hypothetical officer, and not an inference, that the white space disclosure existed and was relevance: see [42] of *Sanderson* cited at §81 below.

49. *AAG1 no different to trust tax return?* as we understood it, Mr Ewart also made the point that, in a case like *Charlton,* where a taxpayer only included a SRN on his return, it would be possible for an AAG1 to contain insufficient information to have satisfied HMRC that there was an insufficiency in the hypothetical taxpayer's return. While this must be so, we do not see how it helps the appellant. We understood Mr Ewart to mean that the HMRC officer could not necessarily infer from the SRN that there was an insufficiency any more than he could do so from knowing it was likely there was a trust tax return in this case. But that is not the test. S 29(6) determines what information is to be treated as known to the officer. It then looks at that information to determine if that officer ought to have known from it that there was an insufficiency. The Tribunal in *Charlton* decided on the first limb of this test that the contents of that actual AAG1 was to be treated as known to the officer because its relevance ought to have been inferred. It went on to decide, on the second limb, although we do not think this was in dispute, that that AAG1 actually contained sufficient information from which the insufficiency was apparent.

50. Mr Ewart has here elided these two tests but is wrong to do so. And if the two tests are not elided, the difference between the facts of *Charlton* and those in this case is apparent. In *Charlton,* the existence and relevance of the information (but not the actual information) on the AAG1 should have been inferred because the SRN meant that an AAG1 satisfactory to HMRC was bound to have been filed with them; but in this case, the existence and relevance of the white space disclosure should not, in our view, have reasonably been inferred because it was no more than a mere possibility.

51. *Purposive interpretation:* Moreover, as a matter of purposive interpretation, if Parliament had intended the contents of a relevant trust return to be deemed to be known to the HMRC officer considering the taxpayer's tax return, then it could have said so. Parliament did say so in respect of (a) the taxpayer's previous two tax returns and (b) the partnership return of any partnership to which the taxpayer belonged. The effect of s 29(7) is that the hypothetical officer is fixed with knowledge of the contents of these additional returns because information contained in these additional returns is by s 29(7) treated in the same way as information contained in the taxpayer's return: it is 'made available' to the hypothetical officer.

52. But trust returns were not included in s 29(7). So Parliament did not intend the hypothetical officer to be fixed with knowledge of their contents merely if they existed: for the contents of a trust tax return to be 'made available' to the hypothetical officer it has to come within (d) and that requires the information within the trust tax return reasonably to be inferred from information under (a)-(c). In other words, the taxpayer must draw HMRC's attention to it. We find that the appellant did not do so in this case.

53. This point has been made before. In *Trustees of the Bessie Taube discretionary settlement trust and others* [2010] UKFTT 473 (TC) the tribunal said:

> [77]… [S 29 (6)] is, as was clearly decided in *Langham v Veltema*, exhaustive, and there is no warrant for extending its meaning on account of S8 A to include returns made by or on behalf of the trustees as well as those made by or on behalf of the individual himself. If Parliament had wished to include trust returns as part of the information relevant to the making of the discovery assessment on an individual beneficiary, not only could they have done so, in our view they would have done so, as they did in relation to taxpayers carrying on a trade, profession business in partnership where it is provided by S 29(7)(a)(ii) the references in this 29 (6) to the taxpayers return include a reference to the relevant partnership return.

54. *Non-existence of trust tax return:* Mr Ewart points out the appellant could not have drawn the white space disclosure to HMRC's attention as a matter of practical reality as he submitted his return in September 2007 while the Settlement put in its return only days before the deadline of 31 January 2008. We accept that but the point does not support the appellant's position. Had the appellant wished to draw the contents of the trust tax return to HMRC's attention, he could have written later. Certainly when he amended his return for an unrelated reason on 11 August 2008 (§10), he could have taken this opportunity to draw the information on the trust tax return to HMRC's attention. He did not. Moreover, the fact that the trust tax return did not exist when the appellant submitted his own return only reinforces the view we have already expressed that there was no reason why the hypothetical officer should have inferred from the appellant's tax return that the trust tax return would contain disclosure relevant to the appellant's tax return.

Conclusion on first issue – the trust tax return

55. We find for the reasons given above that, as at the date the enquiry window closed, the information contained in the white space disclosure on the trust tax return was not information the existence of which and the relevance of which to the insufficiency in the appellant's assessment could reasonably have been expected to be inferred by an officer of HMRC from information within s 29(6)(a)-(c) and in particular it could not reasonably have been expected to be inferred from entries the appellant's tax return.

56. Having dismissed the appellant's primary case, we go on to consider its secondary case.

Second issue – the information on the appellant's tax return indicated insufficiency?

The s 29(5) condition

57. As we have said, section 29(5) required HMRC to show that, at the time the enquiry window closed (s 29(5)(a)), an officer could not have been reasonably expected to be aware of the 'situation mentioned in subsection (1)' on the basis of certain information. So, as we have said, we need to determine:

> (a) The date at which the enquiry window closed;
>
> (b) The situation mentioned in subsection (1);
>
> (c) The information made available to the officer;
>
> (d) Whether, taking into account this information, this hypothetical officer could not have reasonably be expected to be aware of the situation at that date

58. As we have said, the date at which the Tribunal must assess what an hypothetical HMRC officer ought to have been aware of is 1 February 2009. And the 'situation mentioned in subsection (1)' was the insufficiency as described in §24 above.

59. We have rejected the appellant's case that the hypothetical officer ought reasonably have been expected to infer the existence and relevance of the white space disclosure on the trust's tax return. So the hypothetical officer had only the contents of the appellant's actual return to go on. The appellant's second case was that that was enough information from which the hypothetical officer ought to have been aware of the insufficiency.

60. As we understand it, its case is that on HMRC's view of the law at the time, no one who was UK resident could claim exemption under a double tax treaty for income paid to them as life tenant from a non-resident trust. As it was clear that the taxpayer was claiming such exemption, said the appellant, the hypothetical officer had enough information before him to be aware of the insufficiency in the appellant's return.

61. The appellant's case requires us to consider the scheme: HMRC's position is that we do not need to do so: the hypothetical officer should not be assumed to be familiar with double tax treaties. We will consider what the hypothetical officer is fixed with knowledge of and we will consider the appellant's case on the law as it applied to the arrangements entered into the taxpayer.

What was the law?

62. Art 3 of the UK/Guernsey Double Tax Treaty read as follows:

> **3(2)**
>
> The industrial and commercial profit of a Guernsey enterprise shall not be subject to United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein….

63. What was section 788 of the Income and Corporation Taxes Act 1988 ('ICTA') and is now section 2 (1) of the Taxation (International and Other Provisions) Act 2010 ("TIOPA") gave effect to double tax treaties entered into by the UK. What provisions such as 3(2) of the UK/Guernsey double tax treaty actually meant for residents of the UK was considered in the case of *Padmore* (1989) 62 TC 352.

64. *Padmore*: Mr Padmore, a UK resident, was a partner in a Jersey-based partnership. The Jersey/UK double tax treaty was in much the same form as the Guernsey/UK double tax agreement set out above. HMRC sought to tax Mr Padmore on his share of the partnership profits, on the basis that, properly interpreted, the double tax treaty was not intended to exempt from tax the income of UK residents. However, the Court of Appeal held that the double tax treaty did apply to the taxpayer's share of the partnership profits and Mr Padmore was exempt from tax on his income from the Jersey partnership.

65. Even before this litigation was resolved, HMRC had moved to counteract the taxpayer's and court's interpretation of the double tax treaty, and Parliament enacted s 62 Finance Act (no 2) 1987 with retrospective effect. This became section 858 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") re-enacting section 112 (4) and (5) of ICTA, and it provided:

> **858 partners and double taxation agreements**
>
> (1) This section applies if –
>
> (a) a UK resident ("the partner") is a member of a firm which-
>
> (i) resides outside the United Kingdom, or
>
> (ii) carries on a trade the control and management of which is outside the United Kingdom, and
>
> (b) by virtue of any arrangements having effect under [section 2 (1) of TIOPA]* ("the arrangements") any of the income of the firm is relieved from income tax in the United Kingdom.
>
> (2) the partner is liable to income tax on the partner's share of the income of the firm despite the arrangements.
>
> *(what is now TIOPA – originally it was the ICTA provision referred to above in §63)

66. The effect of this was not in dispute and that was that it reversed the Court of Appeal's decision in *Padmore.* UK residents who were partners in an overseas partnership were liable to tax on the income they received from the partnership, irrespective of where the partnership traded.

67. The appellant in this case presumably took the view when he completed his tax return, although nothing turns on whether or not this was his view, that this provision had no application to his income from the Guernsey trust because he was not himself a partner in an overseas partnership. It was the trust that carried on business in partnership: he received the income as life tenant and not as a partner.

68. After the appellant had completed his tax return, and some twenty years after the original enactment, Finance Act 2008 section 58 (3) inserted new subsection (4) into section 858 ITTOIA. It came into force on 21 July 2008. That read as follows:

> (4) for the purposes of this section the members of a firm include any person entitled to a share of income of the firm.

69. It was accepted that the effect of that amendment was to bring income paid to a UK resident from a foreign partnership into tax even if the UK resident was not a partner in the partnership. It included income from a life tenancy of a trust where the trust traded in partnership. This caught the appellant's life tenancy income in 2006-7 because, and only because, the amendment was retrospective as it was deemed by statute always to be in effect.

70. There was a failed attempt to challenge this legislation by judicial review, including its retrospective nature: *R (oao Huitson)* [2010] STC 715. The appellant points out that the explanatory notes to the Finance Bill for this clause stated, as recorded at page 733 of *Huitson* that:

> the government believes that a partner for the purposes of that legislation always included those persons entitled to a share of income or capital gains of the partnership. As such, the UK individuals remain liable to UK tax despite the elaborate, artificial structure designed to exempt them. This clause will put it beyond doubt that the legislation always had that effect.

71. In other words, the Government sought to justify the retrospective nature of the legislation by saying it did not more than state what had always been the law. The Judge was not, however, convinced. Parker J's comment on that was:

> [71]… I have significant doubt whether "member of a firm" could extend to a person in the claimant's position but, given the background, and the need to interpret anti-avoidance legislation in a strongly purposive manner, I could not rule out the possibility that, if the point had been litigated, HMRC might have succeeded in persuading the court that its interpretation was correct.

The relevance of this is that it is the appellant's case that, on HMRC's view of the law as at the time the enquiry window closed, whether right or wrong, the appellant was liable to tax on income from a foreign partnership even though he claimed exemption under the double tax treaty. The hypothetical officer should have known this, says the appellant.

72. There were, we were told, concerns that the possibilities of using that particular provision of double tax treaties to avoid tax on income from businesses in the UK were not entirely exhausted by this legislation. The concern was that an 'enterprise' might include a sole trader, so a trust could trade as a sole trader and pay the profits to its UK resident life tenant and rely on s 3(2) of the Guernsey/UK double tax treaty or equivalent provision of another double tax treaty to avoid tax.

73. To counter this concern, the last piece in this legislative jigsaw was new section 815AZA (now s 130 TIOPA) also inserted by Finance Act 2008 into ICTA. Unlike the above provision s 858(4) ITTOIA inserted by the same Finance Act, this was not retrospective. New section 815 AZA applied in respect of any income arising on or after 12 March 2008. It provided:

> (1) Subsection (4) applies if double taxation arrangements make the provision, however expressed, mentioned in subsection (2).

> (2) the provision is that the profits of an enterprise within subsection (3) are not to be subject to United Kingdom tax except so far as they are attributable to a permanent establishment of United Kingdom.
>
> (3) an enterprise is within this subsection if the enterprise-
>
> (a) is resident outside the United Kingdom, or
>
> (b) carries on a trade, profession or business, the control or management of which is situated outside the United Kingdom.
>
> (4) the provision does not prevent income of a person resident in the United Kingdom being chargeable to income tax or corporation tax.
>
> (5) subsection (4)-
>
> (a) does not apply in relation to income of a person resident in the United Kingdom if section 858 ITTOIA … applies to the income, and
>
> (b) [not relevant]
>
> (6) A person is resident in the United Kingdom for the purposes of this section if the person is resident in the United Kingdom for the purposes of the double taxation arrangements.

74. The effect of this was that any UK resident receiving income from a foreign enterprise was liable to tax on that income even if a double tax treaty provided that the enterprise was not liable to UK tax. It did not apply to the appellant's life tenancy income declared on his 2006-7 return for two reasons: firstly, that income arose from a partnership and was caught by s 858 ITTOIA (excluded by 815AZA(5)(a)) and secondly, in any event, s 815AZA only applied to income arising after 12 March 2008. The relevance of s 815 AZA to the appeal was the appellant's case that there was enough information on the tax return to deduce the insufficiency.

What was a hypothetical officer reasonably expected to know?

75. As stated above the relevant condition is s 29(5) TMA (§16 above) which provided in paraphrase:

> …at the time when [the enquiry window closed] an officer of the Board ….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.

76. The meaning of this has come before the Court of Appeal a number of times but most recently in the case of *Sanderson* [2016] STC 638. The Court summarised how the interpretation of s 29(5) should be approached in [17]:

> (1) the tribunal must consider the awareness of a hypothetical HMRC officer
>
> (2) that officer has the characteristics of an officer of general competence, knowledge or skill which includes a reasonable knowledge and understanding of the law (citing *Lansdowne* [2012] STC 544 CA)
>
> (3) if the law is complex even adequate disclosure may not make the hypothetical officer aware of the insufficiency

(4) the awareness must be of an actual insufficiency (citing *Langham v Veltema* [2004] STC 544*)*

(5) awareness can only come from the sources of information specified in S 29(6) (citing *Langham v Veltema)*

77. We will consider these points in detail.

(1) and (2) the hypothetical officer

78. The first of these points is clear and uncontroversial and that is that the test is objective in that the Tribunal has to consider the awareness of a hypothetical officer at the date the enquiry window closed.

79. In the Upper Tribunal in *Charlton* there was discussion of the qualities of the hypothetical officer.

> [55]… The officer referred to in S 29 (5) is a legal fiction stop he does not require to be imbued with personality or any particular characteristics. To do so inevitably involves seeking some form of or average officer, the search for which, in our view, is futile. The purpose of S 29 (5) is to make it clear that the test of reasonable awareness is objective, and does not depend on the particular individual officer who considers the information made available.
>
> …
>
> [57] the requirement to consider a purely notional officer makes irrelevant the particular officer who considers the return stop it also makes irrelevant the way in which HMRC organises itself into separate departments dealing with certain specialist issues.… The average officer may not be a specialist, but in our view the requirement of S 29 (5) to consider the reasonableness of the awareness of a hypothetical officer does not carry with it the need to confine the view to that through a prism of the eyes of an officer of only general capability and experience.
>
> [58] there is thus no single eponymous hypothetical officer. ……. The officer must be assumed to have such a level of knowledge and understanding that would reasonably be expected in an officer considering the particular information provided by the taxpayer.

80. What the Upper Tribunal at [58] appears to be saying is that the greater the disclosure, the greater the level of knowledge the HMRC officer ought to be presumed to have on the basis that a detailed disclosure would be considered by an officer able to deal with it. In *Charlton*, the hypothetical officer was fixed with knowledge of the contents of the AAG1, as well as the contents of the tax return (which on its face had a large income cancelled out by an equal loss). The AAG1 informed him how the scheme was intended to work and the legislation on which it relied: that was held to be sufficient to fix him with knowledge of the insufficiency bearing in mind that at the time the enquiry window closed the courts had already held that the scheme in a case with very similar facts failed.

81. In *Lansdowne*, on the face of the information provided with the return, it was clear that the taxpayer deducted from its profits rebates paid to its partners. The Court of Appeal ruled that the hypothetical officer ought to have known that as a matter of

decided case law that a partnership was not entitled to do this, so that HMRC was fixed with knowledge of the insufficiency before the enquiry window closed.

82. So the hypothetical officer is in general taken to understand the law as it relates to the facts disclosed by the taxpayer.

(3) complex law

83. However, the Court of Appeal in *Sanderson,* following a line taken in earlier cases, said that even where there is full disclosure of the facts it may not be enough to fix the hypothetical officer with knowledge of the law where the law is complex. Nevertheless, there has never been a case, at least we are not aware of any case, where it was decided the law was too complex for the hypothetical officer to be deemed not to know it and it is not alleged that that was so here.

84. But what if the law is unclear rather than complex? The Chancellor in *Lansdowne* at [56] (cited also in *Charlton* at [52] and *Sanderson* at [23]) said that an HMRC officer is not required to resolve points of law. What does this mean for a taxpayer who has completed his tax return fully disclosing all relevant facts but on a particular view of the law which others might interpret somewhat differently? Does that mean the hypothetical officer is not fixed with an awareness of the insufficiency (should the taxpayer's view prove to be wrong) because the hypothetical officer is not required to resolve an uncertain question of law? We think that the answer may be that where interpretation of the law is uncertain, the taxpayer needs to disclose not only the law on which he relies but his view of the law.

85. The Court of Appeal in *Sanderson* considered whether the hypothetical officer ought to be taken to be aware of the views of the specialist office within HMRC considering the scheme used by the taxpayer and in particular whether the hypothetical officer was deemed to know the view of the specialist office that the scheme was ineffective. At [37] the Court of Appeal concluded that he should not:

> [37]… The exercise postulated by S 29 (5) is a consideration by the officer of the information disclosed by the taxpayer by reference to the relevant legal principles: not by reference to what some particular department or officer at HMRC may at the time have thought about the efficacy of the scheme then under investigation

86. The Court of Appeal also considered whether the hypothetical officer should be fixed with knowledge of the results of HMRC's investigations into the scheme:

> "[40] what the appellant seeks to have attributed to the notional officer here is information obtained by a department within HMRC as a result of its own investigations into the scheme. There is nothing in the contents of Mr Sanderson's return to indicate that the scheme has been under investigation or that some relevant information about a possible insufficiency is in the possession of HMRC"
>
> …
>
> [42] in this case it would have been entirely speculative rather than a matter of inference from the return for the notional officer to have concluded that

> another branch of HMRC might have relevant information on the effectiveness of the scheme. There is no basis on which the existence of such information could reasonably be expected to be inferred from the limited disclosure in the return."

87. So it seems the hypothetical officer is not fixed with HMRC's view that the scheme does not work unless the taxpayer draws this to the officer's attention in his disclosure. But where the law is clear that on the facts disclosed by the taxpayer that there is an insufficiency, then the hypothetical officer is fixed with knowing this, save where the law is too complex. No one suggests the law in this appeal was too complex.

88. It is also clear that the hypothetical officer is not deemed to consult with more specialist colleagues even if, in the real world, it might be supposed that that is what an HMRC officer considering the taxpayer's return would do: *Charlton* at [53].

(5) awareness from sources of information within s 29(6)

89. We have already considered this requirement at §§19-56 above and concluded that the sources of information available to the hypothetical officer did not include the trust tax return but did of course include the appellant's 2006-7 tax return.

(4) awareness of actual insufficiency

90. *Sanderson,* as well as earlier cases, identified that s 29(5) is intended to focus on the extent and quality of the taxpayer's disclosure and not on the qualities of the hypothetical officer. The awareness must be of an actual insufficiency. One of the most difficult issues with s 29(5) is the meaning of 'awareness'. As the Court of Appeal recognised in [18] in *Sanderson*:

> "Where there is more scope for argument is in relation to the level of awareness that the relevant information needs to create in order for the condition to bar the right to raise a 29 (1) assessment. In the present context, for example, is it necessary for the information disclosed to lead the notional officer to conclude on the balance of probabilities that there is an insufficiency, or must he be satisfied beyond reasonable doubt? Alternatively is some quite different test to be applied?..."

91. In *Langham v Veltema,* the Court of Appeal made it clear that the hypothetical officer had to have more than merely enough information to justify opening an enquiry before HMRC would be shut out from a discovery assessment:

> [32] If, as here, the taxpayer has made an inaccurate self-assessment, but without any fraud or negligence on his part, it seems to me that it would frustrate the scheme's aims of simplicity and early finality of assessment to tax, to interpret S 29 (5) so as to introduce an *obligation* on tax inspectors to conduct an intermediate and possibly time-consuming scrutiny, whether or not in the form of an enquiry under s 9A, of self-assessment returns when they do not disclose insufficiency, but only circumstances further investigation of which might or might not show it… It would appear to me to be consistent with the aims of simplicity and speed of the new statutory scheme as I read it, namely that there is nothing in the Act that obliges a Revenue officer to enquire into the return, for example in the case such as this, to obtain expert

> valuation evidence for the purpose of checking the accuracy of evaluation indicated return.
>
> [33] more particularly, it is plain from the wording of the statutory test in S 29 (5) that it is concerned, not with what an Inspector could reasonably have been expected to do, but with what he could have been reasonably expected to be aware of. It speaks of an Inspector's objective awareness, from the information made available to him by the taxpayer, of "the situation" mentioned in S 29 (1), namely an actual insufficiency in the assessment, not an objective awareness that he should do something to check whether there is such an insufficiency,…
>
> Per Auld LJ

92. In *Sanderson,* the Court of Appeal answered its question this way:

> [22] ... The hypothetical officer must, on an objective analysis, be made aware of an actual insufficiency in the assessment by the matters disclosed in the S 29 (6) information….
>
> [23] …. The decision in *Lansdowne* confirmed that the officer was not required to resolve (or even be able to assess) every question of law (particularly in complex cases) but that where…. The points were not complex or difficult it was required to apply his knowledge of the law to the facts disclosed and form a view as to whether an insufficiency existed. It is a matter of judgement rather than the application of any particular standard of proof…..

93. <u>Is actual awareness of insufficiency the same test as for raising an assessment?</u> The authorities above cited are clear that disclosure is insufficient to protect the taxpayer from a discovery assessment if the disclosure did no more than raise a suspicion of an insufficiency rather than an awareness of an actual insufficiency; it is not enough to put just enough disclosure in a tax return which would raise questions in the mind of the hypothetical officer such that he might have decided to open an enquiry. The disclosure must give the officer awareness of an actual insufficiency (see discussion in *Sanderson* at [17] citing *Langham v Veltema* at [33])

94. Yet other cases say that the test for disclosure is whether it is sufficient to justify an assessment. In particular Lewison J in *Lansdowne* [48] in the High Court said that test was 'whether HMRC had sufficient information to make a decision to raise an additional assessment. That seems to me to be the right test.' And this was referred to in *Charlton* at [52] and also cited in *Sanderson* at [19].

95. This appears to create a tension. If 'awareness of insufficiency' is the same test as applies to whether HMRC are entitled to raise an assessment, this would appear to encourage taxpayers not to provide HMRC with information, which goes against the grain of the purpose of the TMA in general and section 29(5) in particular. This is because HMRC are entitled to assess where they merely have an honest belief in an insufficiency, even if their knowledge of the details is very scanty (eg see *Haythornthwaite & Sons Ltd* CA 1927 11 TC 657) so if the tests are the same, that would that would suggest that scant information might nevertheless be sufficient disclosure for s 29(5). And conversely, if the 29(5) test of actual awareness of the insufficiency applied to assessments, then that would suggest that HMRC could not make assessments where the information was scant.

96. This tension was expressly considered by the Court of Appeal in *Sanderson.* Counsel for the taxpayer put the case at [24] that the test for an assessment is that an officer merely has to justify his belief further tax is due and that therefore the bar for adequate disclosure under s 29(5) was low. The Court of Appeal's reply was:

> [24] ... The threshold is said [by the appellant] to be a relatively low and merely requires the officer to be able to justify his belief that further tax is due. Part of [the appellant's] argument rests on eliding the requirement in S 29 (1) for an officer to "discover" that there is an insufficiency in the return with the condition in S 29 (5) that the notional officer could not have been reasonably expected, on the information available, to be "aware" of that insufficiency. Unless, it is said, the threshold of knowledge is set relatively low it would be difficult, if not impossible, in most cases for the Revenue to be able to raise an assessment under S 29 (1).
>
> [25] I do not accept that subsection 29 (1) and (5) import same test… The exercise of the S 29 (1) power is made by a real officer who is required to come to a conclusion on the possible insufficiency based on the available information at the time of the discovery assessment is made. Section 29 (5) operates to place a restriction on the exercise of that power by reference to a hypothetical officer was required to carry out an evaluation of the adequacy of the return at a fixed and different point in time on the basis of fixed and limited class of information. The purpose of the condition is to test the adequacy of the taxpayers disclosure, not to prescribe the circumstances which would justify the real officer in exercising the S 29 (1) power….the tests are not the same.

97. In other words, the test for an assessment and the test for a bar on discovery are not the same. HMRC may have sufficient disclosure to raise a discovery assessment because of a 'possible insufficiency' (see [25] of *Sanderson)* under s 29(1) but that disclosure may be insufficient to protect a taxpayer from such an assessment because the disclosure did not create awareness of an <u>actual</u> insufficiency.

98. <u>Details of scheme lacking:</u> The Court of Appeal went on to apply its test in the practical circumstances of the case before it. Mr Sanderson had entered into a tax avoidance scheme which involved the generation of a paper loss. His tax return showed a real and very substantial gain wiped out by this loss. At the time the tax return was submitted, and certainly by the time the enquiry window closed, HMRC's view of the scheme utilised by the taxpayer was that it was ineffective (and by the time of the hearing the taxpayer agreed).

99. The Court of Appeal first considered whether it was enough to create awareness of the insufficiency that the tax return on its face showed a large gain cancelled by a large loss, particularly when it was clear that the loss had unusual features such as that it arose from an asset owned only for one day and from which minimal income had been derived. Even though the tax return did not reveal the full particulars of the scheme and in particular its self cancelling nature, the tax payer's position was that a hypothetical officer, knowing the *Ramsay* line of cases, knew enough to assess the gain.

100.The Court of Appeal did not agree [35]. There was enough information for the hypothetical officer to suspect an insufficiency but not enough for him to be aware of an actual insufficiency.

101.The distinction between this case and *Charlton* seems to be that in *Charlton*, because the hypothetical officer was fixed with knowledge of the contents of the AAG1 he was taken to know the full structure of the scheme and the legislation on which it relied: he was also taken to understand the law at the time the enquiry window closed, by which time the courts had held that the scheme did not work. In *Sanderson*, the hypothetical officer was only fixed with partial knowledge of the structure of the scheme and had not been informed of the legislation on which it relied. HMRC were unable to make a discovery assessment in *Charlton* but were able to do so in *Sanderson.*

Application to facts of this case

102.We must apply the above principles to this case.

103.What facts must be treated as known to the hypothetical officer at the date the enquiry window closed?

104.We have already ruled that he must not be treated as fixed with knowledge of the existence or contents of the trust tax return. From the taxpayer's own return he knew:

> (1) The appellant received income as life tenant of a trust
>
> (2) The appellant claimed the income was exempt under s 3(2) of the double tax treaty which relieved UK trading income from tax.

He did not know that

> (3) The trust traded in partnership. This information was nowhere provided by the appellant but was only included in the white space disclosure on the trust tax return (which we have found was not information deemed to be known to the hypothetical officer).

105.The hypothetical officer is fixed with knowledge of the law at least in so far as it is clear. On the date the enquiry window closed, it was clear that a UK resident life tenant of a trust trading in partnership in the UK at any time, including 2006-7, was not entitled to relief under s 3(2) of the double tax treaty. This is because the law was changed with retrospective effect on 21 July 2008 by the addition of s 858(4) ITTOIA (§§65-69).

106.However, the hypothetical officer did not know that the trust traded in partnership at this date so, while he may have had suspicions of an insufficiency, on the basis of the case law cited above he did not have an awareness of an actual insufficiency. This is a case of inadequate disclosure by the taxpayer. Had the taxpayer disclosed before the enquiry window closed that the income arose through a trade in partnership, the answer may well have been different.

107.The appellant's answer to this point, as we understand it, is that either the HMRC officer should have inferred that the trust traded in partnership, or that in any event whether it traded on its own or in partnership, HMRC's view was that the income of a UK resident from that trade was taxable.

108.We do not agree. It is not for HMRC to infer crucial elements of the scheme. Taking into account the information disclosed by the appellant, the hypothetical officer could not have deduced that the trust did trade in partnership: it was at least as much a possibility (on the information known to the hypothetical officer) that it traded in its own right. In *Sanderson*, the taxpayer failed to disclose significant facts about the scheme, such as its self-cancelling nature. His disclosure should have been enough to make HMRC suspicious but not enough to satisfy them of the insufficiency. The same is true here: while a large income was shown as wiped out by a relief, a crucial element (the trust's trade being in partnership) was not disclosed, and even if, say, an officer may have suspected this, it was not disclosed.

109.And in so far as it was the appellant's case that the trust's trade being in partnership was not relevant to the appellant's tax position, we cannot agree. At the time the enquiry window closed it was clear that the trust income in the hands of the appellant was taxable *if* the trust had traded in partnership. This should have been clear because of the retrospective amendment to the law as described above. The hypothetical officer is taken to know the law where it is clear. There is no suggestion this was too complex.

110. But if the trust had traded by itself, and not in partnership, any liability to tax of the appellant on income from the trust is very doubtful. We agree with HMRC that the tribunal does not need to resolve this question of law; the question is what the hypothetical officer would have known at the date the enquiry window closed. As described above at (§72-74), HMRC moved to change the law to ensure that such income would be taxable in future but this was with effect from a date after the appellant's receipt of the income. At the date the enquiry window closed, the hypothetical officer could not have reasonably come to the conclusion that the appellant would be liable to tax on that income even if the trust did not trade in partnership. Even if there were officers within HMRC who took that view of the law (although we were not shown that this was the case, unlike with the retrospective change – see §70), the hypothetical officer would not be deemed to share the view (§§83-88). The law was on the point of sole trader enterprise was at best uncertain. If the appellant had disclosed that the trust traded in partnership, then may be the position would be different. But he did not.

111.We accept that if the law at the time was clear that the trade being in partnership was irrelevant to the appellant's tax liability then disclosure of the partnership was unnecessary: but that is not the case. On the law as it stood at the time the enquiry window closed with respect to the 2006-7 income, looked at by the hypothetical officer with knowledge of the retrospective change in the law, the appellant was clearly liable to tax if the trust had traded in partnership but (so far as the hypothetical officer at the time ought reasonably have concluded) might very well not be liable to tax if the trust traded in its own right. He would therefore only have been aware of an

actual insufficiency if he had been made aware the trust traded in partnership. He was not.

112. In conclusion, we consider that the failure by the appellant to disclose that the trust traded in partnership meant that at the date the enquiry window closed the hypothetical officer ought not reasonably to have been aware of the insufficiency. We dismiss this submission on behalf of the appellant, which leaves only the question of whether HMRC actually made a discovery.

Was there a discovery?

113. It was not originally a part of the appellant's case that there was no discovery. Nevertheless, following the Upper Tribunal decision in *Burgess* and *Brimheath Developments* [2016] STC 579 HMRC were concerned that they needed to prove that there was a discovery even though this point was not in issue. They sought leave to amend their grounds of appeal: the appellant did not object to the amendment but did put HMRC to proof that there had been a discovery.

Our findings of facts

114. Mrs Beverley Naylor, an HMRC officer, gave evidence. She gave a witness statement and appeared for cross examination. We accept that evidence.

115. From around June 2009 until some point in 2013, she worked in HMRC's Specialist Investigations ('SI') team investigating avoidance schemes using double tax treaties. The team comprised Mr Alan Branigan, Mr Dave McDougall and herself. The team investigated about 3,000 taxpayers. The SI team had an arrangement with another team, Charity, Assets and Residence ('CAR') that if CAR discovered a trust which might be connected with such an avoidance scheme, they would notify the SI team.

116. Any individual identified as a potential user of a double tax treaty scheme was entered onto a database. The appellant was at some point entered onto that database. The relevant SI team also at some point set up a file for each potential user, including the appellant. The Tribunal had a copy of that file reconstructed so far as possible to appear as it did on the date of the discovery assessment although we accept Mrs Naylor's evidence that the reconstruction was imperfect.

117. The appellant's file with HMRC shows that an HMRC officer (Sue Edwards), who carried out administrative support for the relevant SI team, on 22 August 2008 requested by fax from another section of HMRC a copy of the appellant's 2006-7 tax return. It seems more likely than not that this fax did not receive a reply as a handwritten note on the top records the fax was resent on 17 February 2009; moreover it was Mrs Naylor's evidence that the SI team requested so many returns it was normal for some requested not to be received, and in any event it seems the appellant's 2006-7 return was still not on the file the team held for him by March 2009 as Mr Branigan requested it a third time and it was actually received on 10 March 2009 (see below).

118. Earlier, on 18 February 2009, an internal HMRC memo between CAR and a different SI team in Bristol, investigating a different avoidance scheme, showed that the Settlement at issue in this appeal was one of a number identified as using a scheme involving the Guernsey/UK double tax treaty. This memo included information about the various trusts referred to, including the white space disclosure on the Settlement's tax return referred to above at §9. The memo was forwarded to Mr Branigan on 26 February 2009. The obvious inference is that the SI team in Bristol had no interest in it but forwarded it to the relevant SI team as it appeared (correctly) to concern the tax scheme that that SI team was investigating.

119. It appears Mr Branigan looked at the HMRC's summary of the appellant's 2006-7 return (which showed little more than issue and return date) on or just after 2 March 2009 as there is a note in his writing on the printout asking Sue Edwards to obtain the appellant's 2006-7 and 2007-8 returns, and a note by Ms Edwards that they were obtained on 10 March 2009 (see §117). Again the obvious inference is that it was receipt of the memo from CAR which triggered Mr Branigan's interest in the appellant's tax returns. Mr Branigan appears to have done nothing further on the file and it is not clear whether he looked at the returns when they were obtained on 10 March 2009.

120. Mrs Naylor's recollection of events is not particularly clear, because, we accept, she saw so many returns in connection with schemes of this sort, but she knows from the files that in February 2011 she looked at the tax returns of other taxpayers who were in receipt of income from the partnership of which the Trustee of the Settlement was a partner. She took certain actions in respect of those other taxpayers. She considers it likely that at the same time she would have looked at the files for all taxpayers receiving income from this partnership, although she has no recollection of actually looking at the appellant's file.

121. Nevertheless, she did take action on the appellant's case at around that time as the file does show that on 8 March 2011 she asked the relevant local compliance team to assess the appellant for the trust income received in 2006-7 for which he had claimed double tax treaty relief and that that request resulted in the discovery assessment at issue in this appeal. Mrs Coulthard was a member of that local compliance team and was the HMRC officer who actually made the assessment (§15).

122. At some point, but it could not have been before she joined the team in June 2009, Mrs Naylor wrote 'discovery needed' across the front of the appellant's file. This was, we find, a note to herself. We find, on the basis of the evidence, she would not have written this note until February-March 2011 (see §124 below).

When did the discovery take place?

123. The appellant's case was that in around March 2009 Mr Branigan had both a copy of the white space disclosure on the Settlement's tax return for 2006/7 and a copy of the appellant's tax return for 2006-7, and, as HMRC conceded, that was enough for a hypothetical officer to be aware of the insufficiency (see §25) and therefore, says the appellant, this Tribunal should conclude that Mr Branigan was actually aware of the

insufficiency. The discovery, says the appellant, took place in March 2009 by Mr Branigan and not two years later by Mrs Naylor.

124.If Mr Branigan did not make the discovery in March 2009, we are satisfied that the evidence shows Mrs Naylor discovered the insufficiency in February/March 2011. This is because we think it more likely than not that she did look at the file in February/March 2011 as that is the only reasonable explanation of her instruction to local compliance to make the assessment: there is no suggestion from the file that she had realised the insufficiency any earlier: if she had, we would have expected her to act on that knowledge and she did not.

125.But did Mr Branigan make the discovery earlier? Mrs Naylor was not a member of the team in early 2009 and cannot say what happened. Nevertheless, the impression we had from Mrs Naylor was that it was a very small team dealing with a very large number of returns and accounts and some correspondence was overlooked. There were, it seems to us three possibilities: it was possible that, having seen the trust tax return and requested the appellant's returns, Mr Branigan never looked at them or that, having looked at them, he then failed to realise (despite his specialist knowledge about these schemes) that an assessment was indicated, or having realised this, failed to make the indicated assessment.

126.We had no evidence from Mr Branigan: we were told this was because he was retired. Bearing in mind it is clear he took no action on the file beyond asking for the returns, and bearing in mind the number of returns it appears the team looked at, it was most unlikely he would remember whether he ever looked at the appellant's returns and so, unlike the appellant, we don't read anything in his failure to give evidence.

127.Is it for HMRC to prove that Mr Branigan did not discover the insufficiency in March 2009 or for the appellant to prove that he did? It is clear that the burden of proof is on HMRC to show that they made a discovery (eg *Burgess and Brimhealth*); it follows that *if* the date of the discovery has significance, it must be for HMRC to prove the date. This is reasonable: HMRC officers make the discoveries; they control the evidence of whether and when a discovery took place. While this may involve HMRC in having to prove a negative (such as proving that a discovery didn't take place before a certain date), the appellant does not control the evidence and is not in a position to make a positive case about when a discovery took place.

128. Our conclusion is that there was an error of some kind but the most likely error is that Mr Branigan, due to the numbers of tax returns his team were considering, did not look at the appellant's file again after 2 March 2009. It was, in our view, unlikely that if he had considered the trust tax return together with the appellant's tax return, with his specialist knowledge of the scheme, he would have failed to realise the insufficiency, or that, having realised an insufficiency, he would have failed at least to note on the file that an assessment was required. It was Mrs Naylor, not Mr Branigan, who wrote on the file that a discovery assessment was needed. So we find Mr Branigan did not make a discovery in March 2009. The discovery was made by Mrs Naylor two years later and just before the assessment was raised.

The law

129. That finding of fact is sufficient to dispose of the appeal as the assessment was made very shortly after the discovery but (as it was argued) we move on to consider the law and in particular whether stale discoveries void assessments. In the Upper Tribunal decision in *Charlton* there was a long discussion of the requirements of s 29(1). It was accepted that there could be a discovery when a new fact emerged or even a change in understanding of the law: a simple change of view by an officer could amount to a discovery:

> [31]….the statutory words were apt to include any case in which for any reason it newly appears that the taxpayer has been undercharged…
>
> [37] In our judgment, no new information, of fact or law, is required for there to be a discovery. All that is required is that it has newly appeared to any officer, acting honestly and reasonably, that there is an insufficiency in an assessment. That can be for any reason, including a change of view, change of opinion, or correction of an oversight…..

That much was not really in dispute. It was accepted that if the discovery was not made by Mr Branigan, then Mrs Naylor's conclusion in March 2011, having considered the trust tax return and the appellant's return, that there was an insufficiency was a 'discovery'. We agree that it newly appeared to Mrs Naylor in March 2011, acting honestly and reasonably, considering for the first time the trust tax return and appellant's return together, that there was an insufficiency in the appellant's self assessment for 2006-7.

130. The meaning and effect of the rest of what the Upper Tribunal said in [37] of *Charlton* was in dispute, as they went on to say:

> ….The requirement for newness does not relate to the reason for the conclusion reached by the officer, but to the conclusion itself. If an officer has concluded that a discovery assessment should be issued, but for some reason the assessment is not made within a reasonable period after that conclusion is reached, it might, depending on the circumstances, be the case that the conclusion would lose its essential newness by the time of an actual assessment. But that would not, in our view, include a case, such as this, where the delay was merely to accommodate the final determination of another appeal which was material to the liability question. Such a delay did not deprive Mr Cree's conclusions of their essential newness for s 29(1) purposes.

131. The appellant's position was that this was part of the judgment of the Upper Tribunal and therefore binding on this Tribunal: the effect, therefore, said Mr Ewart, was that if this Tribunal concluded that another HMRC officer had earlier reached the same conclusion as that reached by the officer making the discovery assessment, then the conclusion had lost its essential newness by the time of the assessment and therefore there was no discovery within s 29. It was also the appellant's position that even if the comment in *Charlton* was not binding on this Tribunal, nevertheless it ought to be accorded respect and followed by this Tribunal.

132.HMRC considered that the comment by the Upper Tribunal made here was not a part of its judgment, but merely comment made in passing ('obiter dicta') and

therefore not binding on the Tribunal. In HMRC's view, the comment was also wrong and it did not matter if another officer had reached the same conclusion earlier.

133.HMRC pointed out that two tribunals had already reached the view that what the Upper Tribunal said here was both obiter and wrong. These were the decisions in *Pepper v NCA* [2015] UKFTT 615 (TC) and *Gakhal and others v HMRC* [2016] UKFTT 356 (TC). All that *Pepper* said on this point was that:

> "[41] …We agreed with the submission of [counsel for NCA] that the observation of the Upper Tribunal in *Charlton* regarding the 'essential newness' of a discovery was obiter and is not supported by the words of the statute."

And, as Mr Ewart pointed out, that Tribunal did not have the benefit of any submissions to the contrary as the taxpayer did not appear and was not represented. In *Gakhal and others,* the comment was discussed at [101-103] and although the Tribunal concluded that there was no staleness on the facts of the case, Judge Bailey said:

> [103] …we would agree…that the passage in *Charlton* is *obiter* and so not binding upon us. We have carefully considered s 29 TMA 1970 but we can find no justification in the wording of that section for holding that the assessment must be raised within a certain period of making the discovery as well as meeting the requirements of Section 34 TMA 1970. In our opinion, the only statutory constraint relating to time is that the assessment must be raised within the time prescribed by S 34. We conclude that the concept of a discovery becoming stale has no relevance insofar as lack of staleness is proposed as an additional condition which must be met in order to raise a discovery assessment.

134.Not only are the views of these two Tribunals not binding on us, neither includes any explicit reasoning for their conclusion that the second half of the Upper Tribunal decision at [37] was obiter. We must decide that for ourselves.

135.The question of whether something is obiter depends, in our view, on whether it was part of the operative judgment of the Upper Tribunal. Did the Upper Tribunal decide that the law precluded stale discovery assessments and then apply that law to the facts of the case in reaching a conclusion that the particular discovery assessment in that case was not stale? Or, alternatively, did the Upper Tribunal discuss the question of staleness without deciding it, merely commenting in passing that if there was a law against stale assessments, the particular assessment in that case was not stale so they did not need to decide the point? If they did the former, then their comments on staleness would be binding and not obiter; if they did the latter, then their comments on staleness would be obiter and not binding.

136.For two reasons, we have reached the view that the comment was obiter. Firstly, the Upper Tribunal made no clear statement that staleness was a part of the law. They said: "…it might, depending on the circumstances, be the case that the conclusion would lose its essential newness by the time of an actual assessment." The use of the word 'might' in particular does not connote a binding interpretation of law. The appellant's view was that the Upper Tribunal was making a binding interpretation that the law included a rule against stale discoveries and used 'might' simply to indicate

that not all assessments made after a reasonable period are stale. But that really illustrates the point that the Upper Tribunal cannot have thought that they were making a binding statement of law: if they had thought that they would have explained why only (on the appellant's interpretation) some discoveries made after a reasonable period would be stale. The better view is that the use of the word 'might' indicates that the Tribunal were discussing, without deciding, whether staleness was a part of the law on discovery.

137. The second reason for concluding that the view was obiter is that the Upper Tribunal must have been aware that such a view was without precedent and, therefore, had they intended to make a ruling on this, they would have explained it in detail and considered, for instance, how such a ruling fitted with the timelimits set out in s 34 and 36 TMA. It would not have been a throwaway remark contained in one paragraph of their decision.

138. Having decided it was obiter, should we nevertheless accord it respect and follow it in any event? The appellant referred us to the comment of Lord Carnwath in *Pendragon* [2015] UKSC 37 where he said:

> [48] …the Upper Tribunal is itself a specialist tribunal, with the function of ensuring that First Tier Tribunals adopt a consistent approach to the determination of questions of principle which arise under the particular statutory scheme in question

and suggested that therefore the First-tier Tribunal should be guided by obiter comments of the Upper Tribunal.

139. We cannot agree that Lord Carnwath here meant to suggest that the FTT was bound by obiter comments made by the Upper Tribunal: he certainly did not say so. And if Mr Ewart meant no more than that the FTT should accord obiter comments made by the Upper Tribunal respect, then of course we agree. But according obiter comments respect requires us to consider them carefully but it does not require us to the follow them if, after proper consideration, we consider them wrong in law.

Is there a concept of staleness in s 29(1)?

140. The reasoning of the Upper Tribunal in [37] so far as we understand it, is that there is such a low threshold for 'discovery' that 'the requirement for newness does not relate to the reason for the conclusion…but to the conclusion itself.' Therefore the Upper Tribunal were suggesting, obiter, that a discovery assessment should not be made too long after the discovery.

141. But with respect, we do think this reasoning is flawed. While s 29(1) is the provision which empowers HMRC to make an assessment arising out of a 'discovery' of an insufficiency, there is nothing on the face of s 29(1) which imports any prohibition against time lag between the discovery and the assessment. Even though the Upper Tribunal was no doubt absolutely right to say that the word 'discovery' imports something 'new', it is clearly the discovery which must be 'new' and not the assessment. While colloquially a s 29(1) assessment is referred to as a 'discovery assessment' there is in fact nothing in s 29 which qualifies the word 'assessment': the

s 29(1) assessment must follow a discovery but there is nothing in s 29(1) which says anything about how soon it must follow the discovery.

142.Moreover, as Judge Bailey said in *Gukhal and others*, Parliament quite clearly intended the timelimits in s 34 and s 36 to apply to s 29 assessments. To import a 'staleness' time limit into s 29 would in many cases make the timelimits in s 34 or s 36 otiose.

143.We think a better understanding of s 29 is that the 'newness' necessarily contained within the word 'discovery' is to do with the quality of the disclosure by the appellant and nothing to do with any time lag between discovery and assessment. Other cases have emphasised that s 29(5) (see *Sanderson* at [25] and *Charlton* at [60]) is all about the quality of disclosure by the taxpayer. The effect is that if the disclosure in the tax return and related documents is sufficiently complete that there is nothing 'new' left to discover under s 29(1), and the taxpayer is protected from a s 29 assessment.

144.It seems to us that a discovery could take place at any time, even before the enquiry window closed. The only time limitation is on the assessment which must comply with the applicable time limits in s 34 and s 36 TMA. On this view it is quite possible for a discovery assessment to be made even if the discovery occurred before the enquiry window closed: while HMRC could have, in such circumstances, opened an enquiry, if the discovery arose from material *outside* the information which the hypothetical HMRC officer of s 29(5) was taken to be aware of, and condition 29(5) was fulfilled (or indeed condition 29(4) was fulfilled) then there is nothing to prevent an assessment under s 29(1) as long as the time limits in s 34 and s 36 are met. And this seems in accordance with Parliament's intention that s 29(5) is about the quality of the taxpayer's disclosure: inadequate disclosure puts the taxpayer at risk of a discovery assessment at any time until the s 34/36 time limits cut in.

(We note in passing, as the point was not in issue, that the s 34 time limit was met in this case as the assessment was made on 18 March 2011 which was in just less than four years after the end of the year of assessment on 5 April 2007: s 34(1). There was no suggestion that condition 29(4) or the extended time limits of s 36 were relevant, both of which would require proof of carelessness: this seems right to us as we do not see how it could be said that the appellant was careless for failing to anticipate a retrospective change in the law.)

145.On this view of the law, it is irrelevant when the discovery was made as long as there was a discovery. We have found that there was a discovery made by Mrs Naylor when she read the trust tax return with the appellant's tax return (XXX) in March 2011 and realised that the appellant had received income arising in the trust from its trade in partnership.

146.We accept that the same new information (the Settlement's trade having been in partnership) could only give rise to one discovery and Mrs Naylor would not have made the discovery in the sense meant by s 29(1) if another officer had earlier come to the same realisation. However, even if our finding of fact at §128 was erroneous,

and the discovery had been made two years earlier by Mr Branigan, that discovery still entitled HMRC to raise the assessment that was later raised.

147.We find Mrs Naylor made a discovery in March 2011 and that entitled HMRC to raise the assessment of 18 March 2011 which was raised. The appeal is dismissed.

148.This document contains full findings of fact and reasons for the 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 31 MAY 2016