DISCOVERY ASSESSMENTS – THE CONSEQUENCES OF THE DECISION IN *CORBALLY-STOURTON*

Keith Gordon[1]

Introduction

The decision by Special Commissioner, Charles Hellier, in *Mrs Lavinia Frances Corbally-Stourton v HMRC*[2] has caused some concern[3] about the apparently increased rights of HMRC to challenge Self Assessment returns outside the scope of a formal enquiry and to raise discovery assessments where an alleged error is subsequently found.

I would certainly agree that the decision is cause for some worry – especially as HMRC are already citing it to justify many of their investigations outside the enquiry rules (and, more importantly, after the expiry of the so-called enquiry window).

However, it should not be forgotten that decisions of the Special Commissioners are not binding precedents – either in the Courts or even before other Commissioners (General or Special) or the new Tribunals. Therefore, whilst one should not ignore such decisions altogether, it is worth considering to what extent the decision could be susceptible to challenge on appeal or, if it is thought that the decision was in fact correct, how its scope might be limited to its own particular facts.

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2 (2008) SpC 692

3 See, for example, the comments of David Rothenberg on *AccountingWeb* (23 July 2008): "*Veltema* is dead … The Special Commissioner's decision in *Mrs Lavinia Frances Corbally-Stourton v Revenue & Customs* has effectively removed the protections which self-assessment supposedly introduced, restoring the discovery process to the pre SA position."

Furthermore, despite the worrying outcome in this particular case (an outcome that I will argue to be incorrect), I hope to show that HMRC's victory in *Corbally-Stourton* will turn out to be pyrrhic in nature. In my view, the *Corbally-Stourton* case should in fact herald a revised understanding of how discovery assessments fit into the Self Assessment régime and a return to the pre-*Veltema*[4] days of being able to rely upon white space disclosures.

Therefore, rather than declaring the death of *Veltema*, I hope to show that for over five years, it has simply been misunderstood and, consequently, much of Statement of Practice SP 1/06 (that came to 'explain' it) can be discarded.

The key to this is the relationship between section 29(1) and (5) of the Taxes Management Act 1970. The first of those subsections sets out in general terms the right of the Revenue to raise discovery assessments; the second, one of the two conditions (either one of which must be met) for a discovery assessment to be lawful. Section 29(5) is framed in terms of the information available to HMRC at an earlier stage in the proceedings; it applies only if, at that earlier stage, HMRC could not have been reasonably expected to have been aware that one of the conditions set out in section 29(1) was satisfied.

The effect of this, perhaps counter-intuitively, is that, if one reads section 29(1) narrowly, then section 29(5) has a broader remit; conversely, a broader approach to section 29(1) has the effect of providing a greater restriction to the application of section 29(5). In my view, the latter approach is the correct one: both from the perspective of the policy behind Self Assessment and (probably, more importantly) the statutory scheme.

The history behind the statutory provisions

The statutory provisions are set out in the Taxes Management Act 1970 (for the purposes of income tax and capital gains tax) and the Finance Act 1998, Schedule 18 (for the purposes of corporation tax). There are also similar codes governing Stamp Duty Land Tax and tax credits.

Although there are modest differences in the wording of the various codes, the general effect of all is the same and I would expect the Courts to strive to interpret them in the same way, wherever possible. For this reason, I will focus on the rules as found in the Taxes Management Act 1970.

4 *Langham (HM Inspector of Taxes) v Veltema* [2004] EWCA Civ 193

In the typical case, a taxpayer will be obliged to make a return of his or her income and capital gains.[5] That return will often include a Self Assessment[6], but, in the absence of a Self Assessment, HMRC will usually make the assessment on the taxpayer's behalf.[7]

The essence of the Self Assessment régime is that the taxpayer assumes the obligations of creating the liability to pay the tax due in respect of a particular year. Previously, a taxpayer was obliged only to provide the former Inland Revenue with enough information for them to make the assessment. If HMRC want to verify entries in a Self Assessment return, they have to do so by opening a formal enquiry into the return whereas, previously, such 'enquiries' were generally conducted before an assessment was finalised.

Self Assessment was introduced in an era where additional obligations on taxpayers were generally imposed alongside additional safeguards[8] and Self Assessment was no exception to this rule. Consequently, it was provided that, for an enquiry to be lawful, HMRC must give notice of their intention to commence the enquiry within a set period (often referred to as the 'enquiry window').[9]

For taxpayers and their advisers, the expiry of the enquiry window in respect of any particular return generally meant that the return could be considered as final. As summarised by the former Inland Revenue's handbook published when Self Assessment was introduced:

> Once the time limit for enquiry has passed the Revenue will not be able to amend a taxpayer's self-assessment and will only be able to make a further (discovery) assessment if the taxpayer has been fraudulent or negligent or has made an incomplete disclosure of information.
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> (Self Assessment: the legal framework, SAT2, para. 4.10)

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5 Taxes Management Act 1970, section 8

6 section 9(1)

7 section 9(3); in which case, the assessment will be treated as if made by the taxpayer and included in the return (section 9(3A)).

8 As Schedule 36 to last year's Finance Act will testify, such an era is now long gone.

9 section 9A. This set period was originally one year from the statutory filing date (i.e. typically ending on the following 30 January); then extended so as to expire, as one would have thought more logical, on the following 31 January. With effect for returns for the 2007/08 tax year and later tax years, the enquiry window expires on the first anniversary of the date on which the tax return is actually delivered to HMRC (although this period is extended in cases where the return is delivered late or amended) (section 9A(2)).

Conditions for a discovery assessment

The references in SAT2 to fraud, negligence and incomplete disclosure relate to the conditions introduced into section 29 of the Taxes Management Act 1970 when Self Assessment came into effect. That section provides that under-assessments of tax that are subsequently discovered may be assessed by HMRC. However, notwithstanding the amount under-assessed (and, therefore, the cost to the Exchequer), under Self Assessment, such a discovery assessment may not be made unless HMRC can prove (on the balance of probabilities) that either:

1. the under-assessment arose as a result of the negligent or fraudulent conduct of the taxpayer or a person acting on the taxpayer's behalf;[10] or

2. there was insufficient information available to the HMRC officer when the enquiry window expired (or, in cases where an enquiry had been opened into the return, when the enquiry was closed).[11]

(The full wording of the relevant parts of section 29 is set out below.)

Thus, section 29 provides two exceptions to the concept that returns may be considered final at the end of the enquiry window. The rationale for these two exceptions is, I suggest, obvious.

Negligent or fraudulent conduct is the only ground for assessments being made up to twenty years after the statutory filing date for a particular return.[12] It is also the criterion for a penalty to be imposed.[13] Negligence or fraud occurs where the conduct of a taxpayer (or a person acting on the taxpayer's behalf) falls some way below the standard that one would objectively have expected as reasonable. For this reason, it does not strike me as totally unfair that taxpayers, whose conduct comes within this heading, should not be given the protection of finality conferred by the mainstream Self Assessment rules.[14]

I should note here that HMRC's interpretation of negligent or fraudulent conduct has become increasingly creative in recent years and I hope to return to this topic in a

10 section 29(4)

11 section 29(5)

12 section 36 (the normal time limit being five years (section 34(1))

13 section 95(1) as it has effect before the introduction of the new penalty rules in FA 2007, Schedule 24.

14 There will, of course, be cases where a taxpayer has acted totally properly but has been let down by a negligent adviser. And I accept that, in such cases, the exposure to a discovery assessment might be deemed unfair, especially if the taxpayer is unable to recover any damages from the negligent adviser.

future article. In this article, however, I wish to focus on the second exception provided for by section 29.

This second exception explicitly refers to the Self Assessment system. In short, it provides that a discovery assessment may be permitted if HMRC could not have spotted the under-assessment in time for the matter to be addressed in the course of an enquiry.

Again, this does not seem unreasonable. If a taxpayer (to take an extreme example) explicitly[15] claims 75% capital gains taper relief in respect of an asset that was owned for only six weeks, the probable under-assessment to capital gains tax should be obvious to HMRC and it should be for them to correct the return in the course of an enquiry. They would have no justification to ignore the error and revisit the matter only after the expiry of the enquiry window.

On the other hand, if a taxpayer[16] believed that 10% of all pension income could be received free of tax and returned only 90% of such income without any explanation of what he or she had done, one might not reasonably expect HMRC to discover the error for several years and, therefore, it would not be unreasonable for HMRC to raise discovery assessments once matters came to light.

The effect of these two exceptions can be observed in typical enquiries into business accounts. HMRC resources do not permit annual enquiries into returns (and Self Assessment was intended to get rid of that culture and that burden on the public purse). If, upon such an enquiry, an error comes to light, where the error is likely to have occurred in previous years, HMRC can raise discovery assessments in respect of those earlier years (typically, going back up to five years, or longer if they can prove negligence or fraud).

Seeking to avoid a discovery assessment

In order to protect taxpayers from the risk of discovery assessments, taxpayers have therefore been advised to include with their return sufficient information to alert HMRC of any areas where doubts might be raised concerning the accuracy of the return. Because of the blank area set aside on the Self Assessment return itself for additional information, such disclosures have become known as "white space disclosures" although such information can equally be provided in an accompanying letter or document (or even, in some cases, sent in separately from the return).[17]

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15 but, let's assume, neither negligently nor fraudulently

16 again, neither negligently nor fraudulently

17 section 29(6)

In paragraph 2.58 of SAT2, the former Inland Revenue said:

> But there may still be some occasions when the taxpayer is uncertain as to the accuracy or completeness of some aspect of the return. In any such case the taxpayer should complete the return on the basis that appears most appropriate and should include full details of the points on which they are uncertain in the return. If they do this and the return is checked at a later stage, they will not be penalised if they were wrong, provided their original view was reasonable and they had disclosed all the relevant facts.

Even in their current guidance, HMRC make clear:

> It is not necessary to provide all the documentation that HMRC might need to quantify that insufficiency if an enquiry into the Return is made.
>
> (Statement of Practice SP 1/06, paragraph 18).

Case law

The leading case in this area is that of *Langham (HM Inspector of Taxes) v Veltema*. That was the first case to highlight how the typical white space disclosure that had generally been used until then was likely to be insufficient to preclude a subsequent discovery assessment. However, it should be noted that, in that case, the taxpayer (Mr Veltema) did not make any such disclosure on or with his return.

This is evident from the facts of that case, as set out in paragraph [14] of Auld LJ's judgment:

> On 30 July 1998 Mr Veltema's accountants, Pannell Kerr Foster, pursuant to TMA 1970, s. 8 and 9, sent to the inspector of taxes at King's Lynn Mr Veltema's tax return, including a self-assessment, for the year ended 5 April 1998. It showed as a benefit received from his employment 'Assets transferred/payments made for you £100,000'. It did not identify the nature of the asset, but there can be no criticism of Mr Veltema or his accountants for that, since there was no requirement in or space on the return form for him to do so. In the schedule to the employment pages of the return, it showed under the heading 'other benefits-in-kind', 'Asset placed at disposal of Employee: £100,000', again without identifying the nature of the asset, but plainly indicating, when read with the return itself that the company had transferred it to him. It is accepted by Miss Simler, on behalf of the inspector, that Mr Veltema disclosed all the relevant information.

The inspector at King's Lynn was in possession also of the P11D return prepared by the company in respect of the benefits provided to Mr Veltema. That, when read with the return, made it totally clear that the £100,000 returned was in respect of the transfer of a house and that £100,000 was its (assumed) market value.

Unsurprisingly, the company's tax return for the equivalent period also made reference to the transfer of the house. First, the disposal of the house gave rise to a chargeable gain; secondly, the provision of the benefit in kind gave rise to an (assumed) allowable deduction in respect of the company's trading profits. Although the two entries in respect of the transfer had the effect of making the transfer tax-neutral as far as the company was concerned[18], the company's tax office made further investigations concerning the accuracy of the £100,000 figure used.

In response, the company provided the company's tax office with a copy of the valuation provided by the chartered surveyors and valuers. At the same time, the District Valuer suggested a value of £160,000 in respect of the property. Ultimately, the company and its tax office agreed a figure of £145,000, though, as already noted, it had no real effect on the company's net liability to corporation tax.

Nevertheless, the revised figure suggested that the self assessment on Mr Veltema's personal tax return had become insufficient.[19] As this came to light after the expiry of the enquiry window, the question for the Court was, therefore, whether or not the former Inland Revenue were entitled to raise a discovery assessment in respect of this newly discovered under-assessment.

The former Inland Revenue argued that the situation came within the scope of both exceptions within section 29. The General Commissioners allowed Mr Veltema's appeal on both points. The Commissioners' finding that there had been no negligence or fraud was not subject to an appeal by the Inland Revenue and therefore the case proceeded to the Courts only in respect of the second exception (the insufficiency of the disclosure).[20]

From the General Commissioners, the case proceeded to the High Court where it was heard by Park J. His Lordship dismissed the Revenue's appeal, holding that to permit a discovery assessment in the circumstances would be both "remarkable" and "unrealistic".

Park J's judgment, however, was appealed by the Revenue to the Court of Appeal where the appeal was allowed by Auld, Chadwick and Arden LJJ.

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18 In those days, Class 1A National Insurance contributions were not payable in respect of such transfers.

19 It appears from the case reports that, implicitly, the £145,000 revised valuation was accepted by (or on behalf of) Mr Veltema personally as well as by the company.

20 It is worth noting that, contrary to current HMRC practice, this case does give an example of an innocent error which, on its own, is not sufficient to justify a subsequent discovery assessment.

Besides a brief mention in *Revenue and Customs Commissioners v Household Estate Agents Ltd*[21] (discussed briefly below) and an even briefer discussion in *Revenue and Customs Commissioners v Vodafone 2*[22], the *Veltema* judgment has not been cited in the higher Courts. It is therefore appropriate to roll the clock forward to its most recent high-profile mention in *Corbally-Stourton*.

Briefly, Mrs Corbally-Stourton had participated in a widely-marketed, aggressive tax avoidance scheme in which she had attempted to purchase from a trust capital losses that she hoped to set off against her capital gains. As one would expect in such a case, Mrs Corbally-Stourton was advised to set out in her relevant tax return in some detail both the nature of the arrangements that she had entered into and also the tax effects that they were intended to achieve. Mrs Corbally-Stourton adhered to that advice, no doubt expecting an enquiry to be opened into her return in the year or so after submitting her return.

No enquiry was opened into her return during this period. However, this was not due to any lack of candour in respect of her disclosure: in fact, quite the opposite. HMRC had (almost certainly on the basis of the disclosure) selected Mrs Corbally-Stourton's return for enquiry, but they then forgot to send the formal section 9A letters in time. As was accepted by HMRC in that case (not that they had any alternative), as no enquiry had been lawfully commenced, their only remedy was to rely upon the discovery provisions in section 29.

It was vigorously argued by Mrs Corbally-Stourton's solicitor that, in the absence of negligence or fraud[23], no discovery assessment could be made because there had been more than adequate disclosure by Mrs Corbally-Stourton in her return and, so, HMRC could not bring the case within the terms of section 29(5).

The Special Commissioner, however, held that (following *Veltema*), at the time that the Revenue ceased to be able to open an enquiry into Mrs Corbally-Stourton's return, the inspector was not in possession of sufficient information to have knowledge of the alleged deficiency in her Self Assessment. Therefore, he was not precluded from raising a discovery assessment at that later stage by which time he could be said to have *discovered* the insufficiency.

Section 29

The relevant extracts of section 29 are as follows:

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21 [2007] EWHC 1684 (Ch)

22 [2006] EWCA Civ 1132

23 neither negligence nor fraud was pleaded by HMRC in the case

29 Assessment where loss of tax discovered

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment–

(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or

(b) that an assessment to tax is or has become insufficient, or

(c) that any relief which has been given is or has become excessive,

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

(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 is attributable to fraudulent or negligent conduct on the part of 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 taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or

(b) informed the taxpayer that he had completed his enquiries into that return, the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

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

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer, whether in pursuance of a notice under section 19A of this Act or otherwise; 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) onwards [Not relevant]

It will be seen that subsection (5) focuses on the information that is available to the hypothetical officer at the time that the enquiry window expires (or when any actual enquiry is closed). Subsection (5) is supplemented by subsection (6) which details the information that is deemed to be available to that hypothetical officer.

At the heart of difference between Park J in the High Court and Auld, Chadwick and Arden LJJ in the Court of Appeal in *Veltema* is the question whether subsection (6) provides an exclusive definition to the phrase "information [being] made available to [the officer]". Park J held that subsection merely deemed the information listed therein as available to the hypothetical officer so that the question as to the sufficiency of the disclosure had to be considered in light of that information *together with any other information that the Revenue would have had in its possession or power readily to obtain*.[24]

The Court of Appeal, however, concluded that *only* information that comes within a category within subsection (6) may be considered.

This is a classical conundrum in the art of statutory interpretation and the task is not made any easier by the differing practices of different Parliamentary drafters, some of whom use the word "if" to mean "only if" – as was held by the Court of Appeal to be the case here – whereas others would explicitly use the words "only if" in such circumstances.[25]

Auld LJ addressed this point by presuming that that a non-exclusive list would have been prefaced by the words "includes any of the following". Whilst that device is indeed used by Parliamentary Counsel, in my respectful opinion, the absence of it in the present context is no more persuasive than the absence of the words "only if".

In my respectful view, neither conclusion is obviously wrong. However, for the purposes of this article, I will proceed on the basis that the Court of Appeal decision is indeed correct.[26] Nevertheless, I will argue that the effect of the Court of Appeal's decision is in fact not as dramatic as is usually assumed, thereby questioning some of the decisions that have been made in its wake.

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24 Park J also held that the words "on the basis of" in subsection (5) allowed other information that would naturally have followed from the actual information supplied to the Revenue to be taken into account.

25 For an example of the latter approach, the reader is referred to the Income Tax Act 2007, section 131(3).

26 However, it should be noted that, had *Pepper (HM Inspector of Taxes) v Hart* been cited to the Court of Appeal, a different result might have been reached. Stephen Dorrell (Financial Secretary to the Treasury) had assured the Standing Committee debating what became the Finance Act 1994 that "information is deemed to be disclosed if its existence and relevance … could reasonably be inferred by the inspector … from information actually available to him. This leg does not depend on the taxpayer taking a further positive step." (*Hansard*, 15 February 1994, Col. 224) Arguably, that would not resolve the issue because the Financial Secretary was merely paraphrasing subsection (6)(d). However, given that he was talking about protection for the taxpayer, it is equally arguable that this is relevant to the "if"/"only if" question.

Analysis of the decision in *Veltema*

Although they disagreed on the interpretation of section 29, both Park J[27] and Auld LJ[28] recognised that, under the Self Assessment scheme, there was a clear need for taxpayers to have certainty within a set period after submission of their tax returns. Both judgments make it clear that the rules permitting the raising of discovery assessments are exceptions to the normal rule that adjustments of self assessments should ordinarily be made through the enquiry procedures. Park J was explicit in his use of the term "exceptions"[29]; it is implicit in Auld LJ's judgment[30]:

> [I]t may be helpful to consider first the underlying purpose of the new self-assessment scheme. It seems to me that its purpose is to simplify and bring about early finality of assessment to tax, based on an assumption of an honest and accurate return and accompanying documentation by the taxpayer. This is subject to the exercise by the Inland Revenue of: (1) whatever routine or random checks that it sees fit to make as a form of 'light monitoring' of self-assessment returns; (2) its statutory power of enquiry under s. 9A where it considers it appropriate; and (3) in the absence of fraud or negligent conduct, subject to further scrutiny thereafter only in the event of newly discovered information and/or reasonably drawn inferences therefrom that the self-assessment was insufficient resulting in loss of tax.

However, when considering the *Veltema* decision, it is important to focus on the facts of the case. It concerned an (apparently) erroneous valuation. The consequence of the case is that HMRC have published guidance on what information ought to be provided in similar cases in the future. For example, in Statement of Practice SP 1/06, HMRC state:

> 12. Most taxpayers who state that a valuation has been used, by whom it has been carried out, and that it was carried out by a named independent and suitably qualified valuer if that was the case, on the appropriate basis, will be able, for all practical purposes, to rely on protection from a later discovery assessment, provided those statements are true.

That would suggest that all Mr Veltema needed to do (at least if he had had the benefit of SP 1/06 when he filed his return) was to state that the £100,000 figure had been obtained from a valuation provided by his named surveyors. However,

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27 at paragraph [10]

28 at paragraph [31]

29 at paragraph [15]

30 at paragraph [31]

paragraph 13 of the Statement of Practice then provides that this rule is subject to exceptions. It is not stated what all of these exceptions are. However, "[t]he main exception will be where, as in the example of a property transferred to a director, the same transaction is the subject of an agreed valuation in a related tax return, that of the company". That is in fact the situation in which Mr Veltema found himself. It is not clear why that should be the exception to the rule because it would mean that Mr Veltema could never have obtained the certainty inherent in the Self Assessment system.[31] However, in my respectful view and as will be explained below, paragraph 12 of the Statement of Practice is not necessarily the logical conclusion of the Court of Appeal's decision in *Veltema*.

The judgments of Chadwick and Arden LJJ are largely in agreement with that of Auld LJ. However, they further consider (reaching contrary conclusions) whether or not section 29(5) permits the Courts to take into account information that was not actually in the Revenue's possession but would have been available to the hypothetical officer had that officer asked for the basis of the valuation of the property. Chadwick LJ held that this information was permitted, but this would not have helped Mr Veltema as the details of the valuation would still not have identified the under-assessment; Arden LJ held that this information was outside the bounds of section 29(6) in any event.[32]

Read superficially, the judgments of Chadwick and Arden LJJ suggest that Mr Veltema's discovery assessment was lawful because the fact that the return understated the value of the property was not made explicit to the Revenue on or with the return.

However, this is clearly an absurd conclusion because, in order to overcome section 29(5), it would require the return to contain an explicit statement that the return is incorrect (rather than a statement only to the effect that liabilities *might* be understated). Indeed, this was a point that was considered by Park J in the Court below:

> Mr Veltema [c]ould have flagged up everything which he possibly could flag up; he [c]ould have gone out of his way, beyond what the return form required of him, to point out to the inspector that the £100,000 was a valuation on which opinions might differ. But if the inspector had to be assumed to limit himself to the materials specified in s. 29(6) (the tax return, accompanying documents, and anything that could reasonably be inferred

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31 Nor is it particularly satisfactory that there is no guidance as to what other circumstances might find themselves as exceptions.

32 In *R & C Commrs v Household Estate Agents Ltd* [2007] EWHC 1684 (Ch), Henderson J expressed his preference for Arden LJ's interpretation.

> from them) he could not have been aware that the self-assessment was insufficient.[33]

What was not addressed in the judgments of either Chadwick or Arden LJ (and no criticism is intended of either, because the matter did not need addressing in the case) is what additional information should have been supplied by Mr Veltema if a discovery assessment were to have been averted.

Analysis of the decision in *Corbally-Stourton*

In contrast to the facts in *Veltema*, the tax return submitted by Mrs Corbally-Stourton contained a relatively detailed account of the basis for Mrs Corbally-Stourton's loss claim. In fact, because she had taken part in a widely marketed avoidance scheme, it is not surprising that she was advised to make a full disclosure of the arrangements so as to provide certainty at the end of the enquiry window.[34] The quality of the disclosure can be favourably compared with that in the case decided by Dr Brice at the end of 2007, *A N Employee v HMRC*[35], where the white space disclosure was not only inadequate but also quite misleading[36].

The Special Commissioner considered the precedent of *Veltema* and, in particular, the judgment of Auld LJ. As with *Veltema*, the key question was the amount and quality of the information available to the Revenue when the enquiry window closed and whether it was sufficient to put the hypothetical officer on notice that something was up.

Mr Hellier noted the test set down by Auld LJ. Citing the judgment in *Veltema*:

> "… [Section 29(5)] speaks of an Inspector's objective awareness, from "the information made available to him by the taxpayer, of "the situation" mentioned in section 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."

However, Mr Hellier noted that to read this part of the judgment literally would lead one to an absurdity. Mr Hellier, quite rightly in my opinion, justified his caution by

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33 at paragraph [33]

34 Given the quality of the disclosure, it would be reasonable to assume that the return was prepared in accordance with the practice generally prevailing amongst professional firms at the time. Consequently, there is an argument that a full defence against the discovery assessment was available to Mrs Corbally-Stourton under section 29(2).

35 (2007) SpC 673

36 arguably, deliberately so

noting that "[a judge's] synopsis of the legislation … should not be read as legislation itself: the words describe in broad term[s] the scheme as an aid to the interpretation of the statute, but do not replace the statute".

He therefore downgraded the level of the hypothetical officer's awareness of the under-assessment from knowledge of the actual insufficiency to an objective awareness:

- that there might be an insufficiency and

- that, on the balance of probabilities, there was such an insufficiency.

On the facts of the case, he held that a mere description of the implementation and effects of a tax avoidance scheme on a tax return could not tell a hypothetical officer that tax was more likely than not to have been under-assessed, merely that there was a possibility of such an under-assessment. It was only at a later stage, after enquiries had been made into returns of other individuals who had subscribed to the same scheme, that the officer became more certain of his ground, leading him to raise the assessment.

Discussion

In my view, Mr Hellier was completely right to restate the 'actual insufficiency' test implied by Auld LJ. Upon review of the facts of the *Veltema* case, it is clear that the information available to the hypothetical officer "did not identify or even suggest a possible insufficiency in the valuation of the market price." The information provided to the Revenue (including that which Park J would have considered) contained solely the fact that a house worth £100,000 had been transferred from the company to him. When Mr Veltema's return ceased to be subject to an enquiry, there was no information available to any officer that the £100,000 figure was significantly deficient.[37] In particular, there was no reference even to the fact that the figure was obtained by a valuation (and, therefore, inherently an estimate) rather than a known market value because, say, the company had only recently acquired the property on open market terms or because, as was quite common at the time, the asset was readily convertible into a known amount of cash.

To continue with the false basis of there needing to be awareness of the actual insufficiency would continue to lead to absurdity, as warned by Park J and

37 The District Valuer had by that stage suggested a higher valuation. However, taking the narrower approach adopted by the Court of Appeal, this fact must be excluded.

acknowledged by Mr Hellier himself.[38]

Consequently, Mr Hellier held that the condition in section 29(1) required "[not] that the officer be aware that there was in truth an insufficiency, but merely that that information should enable him to conclude on balance that there was an insufficiency … a mere suspicion would not be enough, but a conclusion in relation to which he had some residual doubt may well be sufficient"[39]. Elsewhere[40], Mr Hellier suggests that the cut-off is where an officer believes that, on the balance of probabilities, there has been an under-assessment

Mr Hellier, therefore, recast the actual insufficiency label to something that was more meaningful in practice: he therefore, imposed a 50% threshold: was it more likely than not that there was an insufficiency.

It is probable that Mr Hellier, when referring to a 50% cut-off, was trying to be kind to taxpayers in requiring discovery assessments to be made only in circumstances where HMRC had at least a 50-50 chance of success. However, as noted above, by raising the threshold for section 29(1) to apply he was correspondingly narrowing the opportunities for a defence to be mounted under section 29(5).

With respect, I would suggest that the bar in section 29(1) is not as suggested by Mr Hellier. In some ways, I suggest that section 29(1) does not require even a 50% chance of success (so that more cases come within section 29(1) yet, correspondingly, more will be excluded by subsection (5)). However, first I wish to dispense with the notion that the threshold for section 29(1) to apply can be considered using percentages or any other mathematical measure.

The first reason for this is that, ultimately, a 50-50 cut-off is arbitrary and not supported by any relevant statutory provision. Whilst the concept of the balance of probabilities imports this threshold, that is no reason to import it into a particular statutory test.

The second reason is more fundamental. Mr Hellier's reference to this threshold is in the context of what an HMRC officer believes: does the officer believe that, on the balance of probabilities, tax has been under-assessed? In my respectful view,

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38 It is suggested that HMRC are equally conscious of the absurdity as evidenced by the terms of paragraph 12 of SP 1/06 and why they refuse to require taxpayers to provide full details in most valuation cases. Indeed, when considered in this light, it perhaps provides an explanation for the otherwise inexplicable exception set out in paragraph 13: the only reason for treating taxpayers in Mr Veltema's position differently is so as to give SP 1/06 the semblance of being consistent with the Court of Appeal's decision.

39 at paragraph [46]

40 at paragraphs [42] and [51]

however, this test attempts to conflate two mutually incompatible concepts: belief and level of knowledge.

A jaundiced practitioner who has engaged with an officer of HMRC in recent years would undoubtedly say that every officer believes that virtually every taxpayer's assessment *is*, to some extent, insufficient. A less jaundiced view is that HMRC officers should know that every taxpayer's assessment *might* be insufficient.

Section 29(1)

In my view, the correct starting point is to consider (without analysing the additional tests introduced for Self Assessment) the basic threshold for discovery assessments under section 29(1). For this, there is a mature body of case law as what is now section 29(1) has a long history.

Whilst section 29(1) and its statutory predecessors have on the face of the legislation a requirement that an officer of Revenue and Customs should "discover" that tax has been under-assessed, the Courts read that test more liberally. For, until any doubts have been resolved by the Courts, an officer's 'discovery' can never be more than speculative.

As Bray J said in *R v Kensington Income Tax Commissioners ex parte Aramayo* (1913) 6 TC 279:

> "*… it would seem therefore most unlikely that the legislation should have intended by the word discover that he was to ascertain by legal evidence. It provides for a later trial, if I may call it so, the question when either party appeals. This is not the time for legal evidence, and it seems to me to be quite clear that the word "discover" cannot mean ascertain by legal evidence; it means, in my opinion, simply "comes to the conclusion" from the examination he makes, and, if he likes, from any information he receives*."

Avory J said:

> "I *think that the word [discover] means "has reason to believe*"."

And Lush J:

> "*Now if you take the word "discover" as I think it was clearly intended to be taken, as merely an alternative to "find" or "satisfy himself", the difficulty disappears*."

Analysing those authorities, Mr Hellier suggested:

> *"It seems to me clear that both these judges and the legislation do not require the inspector to be certain beyond all doubt that there is an insufficiency; what is required is that he comes to the conclusion on the information available to him and the law as he understands it, that it is more likely than not that there is an insufficiency. I shall call this a conclusion that it is probable that there is an insufficiency.*
>
> *It is clear however that mere suspicion, something short of a conclusion that it is probable that there is an insufficiency is not enough*."

I am broadly in agreement with Mr Hellier. However, in my respectful opinion, and as mentioned above, I would challenge the imposition of the 50% threshold.

The rationale behind the old cases is to ensure that discovery assessments were not declared unlawful because, pending judicial pronouncement, no Revenue officer could ever *know* that tax had been under-assessed[41]. In a similar vein, it must be right that, pending resolution of the matter by the Courts, a more accurate formulation must be that section 29(1) requires an officer to have reason to believe that tax *might* have been under-assessed.

This is because (in tax cases in particular) there are usually two potential areas of dispute: disputes of fact and disputes of law. Where the law is clear, but the facts are in doubt, an HMRC officer (arguing for the position that gives rise to the additional tax liability) will have reason to believe that the true facts of the case are such that tax has indeed been under-assessed. However, where the law is in doubt, even where the facts are not disputed, can an HMRC officer ever say that he or she has reason to *believe* that there is an under-assessment? Until proper judicial consideration of the matter, surely, the most that the officer could claim is that tax *might* be found to be due. This threshold would not be so high as to require a 50-50 likelihood of there being a further tax liability – as suggested by Mr Hellier – merely enough for the officer's further interest in the matter not to be unreasonable.

In the days before Self Assessment, a discovery assessment would have been validly issued (and therefore satisfied what is now section 29(1)), if the officer had sufficient information that meant that the officer honestly believed the taxpayer to be liable for the additional tax.[42] Arguably, that test has not changed and, until an officer has acquired sufficient information to reach that level of knowledge, the section 29(1) threshold is not met. Consequently, enough imputed ignorance at the

41 except in those rare cases where (as was the case in *Veltema*) the only question before the Court is the legality of the discovery assessment itself.

42 *R v Commissioners of Taxes for St Giles and St George Bloomsbury ex parte Hooper* (1915) 7 TC 59

end of an enquiry (or at the expiry of the enquiry window) will be sufficient to allow a discovery assessment to be made at some later stage. However, to retain that threshold in the interpretation of section 29(1) post Self Assessment overlooks the fact that section 29 was completely restated for the Self Assessment era. Under Self Assessment, the role of the discovery assessment was significantly diminished, explicitly by the introduction of the conditions in section 29(3)—(5). However, more subtly, Self Assessment was introduced to give, what is now HMRC, greater enquiry powers in the immediate aftermath of the filing of a return, with the discovery assessment being a residual weapon available to be used in extreme cases. On this basis, it is my view that the better interpretation of the threshold in section 29(1) is that it is *reasonable* for the officer to believe that tax *might* have been under-assessed.

Arguably, this makes discovery assessments easier than before Self Assessment as it no longer requires an officer's honest belief in the existence of the under-assessment. However, one must also factor in the additional hurdles (in section 29(3)—(5)) that were explicitly introduced when Self Assessment came in. Furthermore, it is not necessarily the case that the changed emphasis of the scope of section 29(1) really changes anything. After all, if an officer of what was then the Inland Revenue thought that she or he had a good technical argument about a particular transaction and this led to a discovery assessment, it would have been hard to criticise the officer's actions as unreasonable simply because the officer did not know (or could not said to have believed) that tax was under-assessed. It would have been perfectly reasonable for an assessment to be raised provided that the officer had a reasonable belief that tax *might* have been under-assessed – leaving it for the Courts to determine the true position.

In my view, the requirement for the belief to be reasonable obviates the need for a strict mathematical test and its inherent flexibility should provide what Mr Hellier subsequently referred to as a fair balance between taxpayer and the State. To use the facts of the *Corbally-Stourton* case, at the time that the enquiry window closed, it was open to an officer of Revenue and Customs to reach the conclusion that tax might realistically been under-assessed: the officer would have been aware that an artificial scheme had been implemented and, whereas Mr Hellier held that the reasonable officer would have been aware that some such schemes work[43], the officer would equally have been aware that some such schemes do not work, either because of their technical deficiencies or because of their poor implementation. Consequently, (under the pre-Self Assessment régime) it would not have been a breach of the officer's duty to have raised an assessment at that time and to put the onus on the taxpayer to disprove the assessment[44]. Of course, under Self Assessment, the officer has the power (and, in my view, the duty) to use the enquiry mechanism to ascertain further information, and that is what section 29(5) is

43 paragraph [66]

44 in accordance with section 50(6)

designed to encourage. On the other hand, *Veltema* and *A N Employee* were cases where the tax return contained insufficient additional information (or, in the *Veltema* case, no additional information). Therefore, there were no grounds at the end of the enquiry window for an officer to have any suspicion that there was an under-assessment; for that reason, when HMRC came across new information at a later date, a discovery assessment was a valid way forward.

The above interpretation of section 29(1) also ensures that sufficient weight is given to the word "discovers" in that subsection. Although, as already made clear, that discovery need not be the ascertainment of a factual awareness, it is established that it requires the learning of something new. In other words, an officer cannot be said to discover the under-assessment of tax simply by re-evaluating information that was previously available to him or her although a discovery assessment could follow an officer newly learning the significance of a previously-known fact.[45]

Mr Hellier justified his decision in respect of the actual discovery by reference to the additional knowledge gleaned by the Revenue in the course of their investigations into the scheme as implemented by other taxpayers, whose tax returns were subject to a valid enquiry. In most other cases, that option will not be available. However, if, as is submitted, the correct test is the reasonableness of an officer's concern about a tax return then it would be unnecessary to find grounds for any greater certainty at a subsequent date or for the officer to prove that at some stage since the end of the enquiry window he or she had discovered something new.

Furthermore, the above analysis ensures that discovery assessments are used only in cases where the officer actually discovers something. In the typical Self Assessment case, it is at least arguable that such a discovery must be in the form of additional information provided *after* the making of the Self Assessment. Therefore, the more information that is provided to HMRC as part of the return, the less likely that there can be a subsequent discovery. However, from a practical perspective, that would simply increase the chances of an enquiry. But that is the whole point of section 29(5). It is to encourage taxpayers to trigger enquiries if they wish to avoid the risk of a subsequent discovery. When sufficient disclosure is made (as was the case in *Corbally-Stourton*) it is then up to HMRC to decide whether or not to open an enquiry. Taxpayers cannot and should not be expected to allow HMRC two bites of the cherry.

This is not, in fact, a radical suggestion as it has already been implicitly endorsed in two decisions of the Special Commissioners: *Corbally-Stourton*, itself, and also in *Lee (and others) v HMRC*[46]. In both cases, the Special Commissioners held, in a

45 *Scorer (HM Inspector of Taxes) v Olin Energy Systems Limited* [1985] AC 645, [1985] *STC* 218, [1985] BTC 181 and *Williams (HM Inspector of Taxes) v Grundy's Trustees* (1933) 18 TC 271

46 (2008) SpC 715 at para [8]

complete break with the pre-Self Assessment era, that until the option of dealing with a matter in the course of an enquiry, nothing can in fact be discovered. In other words, if, during an enquiry window, HMRC have any information that suggests tax might have been underpaid, but they decide not to open an enquiry, it will not be possible for them to raise a discovery assessment, because there will not be any valid discovery.

What did Mr Veltema need to do?

As previously noted, Mr Veltema did not provide any information at all concerning the quantification of the £100,000 benefit in kind. However, what would have happened had there simply been a note to the return stating that the £100.000 figure represented a valuation? For this purpose, I do not go so far as to suggest that the return should have stated that there had to have been made by professional valuers, who those valuers were nor the basis of the valuation. I simply consider an explicit statement that (implicitly) highlights that the figure is to some extent subjective.

Provided that it is clear that such a figure is included in the return, it is my view that a discovery assessment is avoidable (assuming of course that there is neither negligent nor fraudulent conduct) for the following reasons:

1. The return makes it clear that the return is based (in part) on a valuation.
2. Thus the fact of the valuation is information within section 29(6)(a).
3. A reasonable inference from this fact is that the valuation might be wrong.
4. In particular, it would be reasonable to infer that the returned benefit in kind might prove to be insufficient.
5. In addition, the relevance of this inference to the potential under-assessment (as required by section 29(1)) could reasonably be expected to be inferred.
6. So, an officer who did not have the option of opening an enquiry at that time could not be criticised for raising an assessment for what the officer reasonably believes to be the correct amount.
7. Thus the potential insufficiency of the self assessment falls within section 29(6)(d)(i).
8. All section 29(1) requires is for an officer to come to the reasonable conclusion that tax has been underpaid.
9. Thus the fact of the situation mentioned in section 29(1) is available to the officer upon the submission of the tax return and, certainly, before the expiry of the enquiry window.
10. Therefore, a discovery assessment is precluded because the condition in section 29(5) is not met.

This conclusion then dispenses with much of the guidance in Statement of Practice SP 1/06. For example, it removes the inexplicable distinction between cases where a valuation affects only one tax return and those where two (associated) returns are affected by the same valuation. More importantly, it overcomes the illogical basis of SP 1/06, which seems to suggest that the more information that is provided about the person who provided the valuation the more that HMRC are implicitly aware of the inadequacies of the valuation itself.

Conclusion

All that section 29 requires (and there is nothing in *Langham (HM Inspector of Taxes) v Veltema* to contradict this conclusion) is that HMRC must be alerted to the inherent uncertainty of a figure in the return. In valuation cases, it will suffice to include a note to state that a particular figure is based upon a valuation.

Where a taxpayer has taken an approach different from that known to be adopted by HMRC in respect of the treatment of a particular transaction (or has participated in a scheme which HMRC is likely to challenge) then it would be sufficient to make an explicit reference to this fact.[47] However, it is my view that full details should not necessarily be included in the return, provided that the return is clear that there is room for an alternative opinion.

Corbally-Stourton was wrongly decided because, at the time that the enquiry window closed, the hypothetical officer was *sufficiently* aware of the potential under-assessment based upon the information provided in the return. This was because Mrs Corbally-Stourton had provided the Revenue with sufficient information about her arrangements in the white space of her return.

The *Veltema* decision was not wrong. However, it was misleading, especially when Auld LJ referred to an actual insufficiency. Whilst it is unfortunate that Mrs Corbally-Stourton's appeal was dismissed, we should be grateful that her case has given us an opportunity to review the *Veltema* decision.

Footnote – Warning!

Whilst this article suggests that full compliance with Statement of Practice SP 1/06 is not strictly necessary, taxpayers and their advisers should clearly continue to consider following that guidance (or even providing fuller disclosures) pending clarification of the scope of section 29(5), (6) by the Courts. However, it is hoped that this article will provide advisers with some comfort in resisting discovery assessments in cases where less than full disclosure was given.

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47 For this reason, I am of the view that Dr Brice's decision in *A N Employee* (on the section 29(5) point at least) was correct.

It will also be noted that some time limits and terminology are likely to change in April 2009.