A 'De Silva' lining?

HEATHER WILLIAMS and **MICHAEL AVIENT** consider the implications of claims included and not included in tax returns as a result of the decision in the *De Silva* case.

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On 15 November 2017, the Supreme Court handed down its judgment in *R (oao De Silva and another) v HMRC* [2017] UKSC 74 (tinyurl.com/y86utnof), which concerned two partners in a film partnership that generated significant trading losses. The taxpayers elected to carry back the losses, the claims being made in the returns for the year before that in which the losses were incurred.

HMRC opened enquiries into the partnerships' tax returns for the respective years of assessment in which the losses were incurred. The automatic statutory effect of this was that enquiries were opened into the corresponding self-assessment returns of all partners. The enquiries were made under TMA 1970, s 12AC (notice of enquiry into a partnership return) rather than TMA 1970, Sch 1A ('Claims etc not included in return') or s 9A (notice of enquiry into a personal return).

Ultimately, the enquiry into the partnership returns was settled under TMA 1970, s 54 and the losses were significantly reduced. As a result, HMRC sought to amend the taxpayers' loss claims.

The taxpayers challenged this by way of a claim for judicial review, arguing that their carry-back loss claims should be regarded as 'standalone' claims that HMRC could challenge only under Sch 1A because they were not made in the tax returns. Further, HMRC was now out of time to do this. They also argued that the claims were not affected by the department's power to amend the partnership's tax returns or their individual self-assessment return forms to give effect to the partnership settlement agreement.

The Supreme Court found that, to deal with this appeal, it needed to consider express provisions of the TMA that:

- deal with the making and processing of claims for relief; and
- specify what a taxpayer must include in his tax return.

On the latter point, reference was made to *HMRC v MD Cotter* [2013] STC 2480 in the context of what a return is and the information in the return that is submitted for 'the purpose of establishing the amounts on which a person is chargeable to income tax and capital gains tax' for the relevant year of assessment and 'the amount payable by him by way of income tax for that year'.

KEY POINTS

- The purpose of TMA 1970, Sch 1A is to assist the cashflow of taxpayers when making valid claims.
- A claim to carry back a loss made outside a tax return may be enquired into under Sch 1A.
- Although a claim has been made outside a return under Sch 1A, a claim to carry back must be included in the return in which the loss is reported.
- Relief given in respect of such a Sch 1A claim would need to be included in the tax return reporting the loss to establish the amount chargeable to income tax in that year.
- An enquiry into the tax return under TMA 1970, s 9A extends to a carry back loss claim necessarily included in the return reporting the loss.

The question of finality

The issues raised by the taxpayer in the Supreme Court went to the core question of finality and when a claim made outside the tax return can be considered final and beyond enquiry under TMA 1970. The earliest year at issue in this case was 1998-99 – during the formative years of the self-assessment regime. If nothing else, on a matter of certainty it is surprising that it should have taken so long to achieve such a goal both for HMRC and the taxpayer.

This was a judicial review and whether the investment arrangements constituted tax avoidance was not relevant. However, from HMRC's perspective a finding for the taxpayer would have had catastrophic consequences because many outstanding tax avoidance cases involved loss claims, sometimes for more than two years, and HMRC had failed to open enquiries into such claims under Sch 1A.

A more pertinent issue, highlighted by the intervening party's submission, was that such an outcome would have also interacted with the legislation introduced in FA 2014 on accelerated payment notices (APNs) and follower notices. This was because one of the conditions to be met to issue a valid notice under this legislation is whether there is an open enquiry into a taxpayer's return or claim.

Further, nearly all APNs issued and collected by HMRC had been predicated on the existence of a valid enquiry. If HMRC was wrong, it would face the ignominy of not only having to accept that many tax avoidance claims were beyond challenge but also repaying millions of pounds in accelerated payments. HMRC estimated that £1bn was at risk to the Exchequer, but anecdotal evidence suggests that figure could have been much higher. In its submissions, HMRC left the Supreme Court in no doubt of the consequences should the taxpayer be successful. The enormity of such a finding may explain the detailed reference to tax avoidance in the facts when no reference is subsequently made to it in the reasoning for the decision.

Back to basics

To recap, TMA 1970 is the primary source of legislation for the administration and collection of taxes. The provisions within it govern the procedures for taxpayers to make self-assessment returns of their income and capital gains and to make claims for relief. It also deals with situations that fall outside self-assessment, such as a claim made outside the return, which was the subject of the *De Silva* appeal.

Just as importantly, TMA 1970 deals with finality and when a taxpayer may regard their tax affairs settled for any self-assessment year or claim. As noted in Peter Penneycard's article 'A Christmas discovery' (*Taxation*, 10 February 2005, page 450), when self-assessment was introduced '...the quid pro quo for transferring the burden of assessment to the taxpayer was the offer of final certainty of liability, in the absence of fraud and negligence, within twelve months of the normal filing date...'. Such certainty was to be achieved through the specified powers of HMRC to enquire into a self-assessment and claim or, in specific situations, to issue a discovery assessment.

> ***"TMA 1970 deals with finality and when a taxpayer may regard their tax affairs settled for any self-assessment year or claim."***

Section 9A provided HMRC with the mechanism to enquire into a taxpayer's self-assessment. Further, if a claim was made outside the return and not within self-assessment a mechanism under Sch 1A was provided for HMRC either to give effect to the claim or to start an enquiry.

The issue in the *De Silva* case related to claims made outside the return. More specifically, the taxpayers made claims to carry back trading losses arising from participation in partnerships. However, the claims were made in their self-assessment returns preceding the year in which the losses were reportable. This was achieved by making an entry in the relevant box of the self-assessment return stating the tax relief being claimed early and detailing the claim in the 'additional information' box (the 'white space'). In the next year's self-assessment return the loss from the partnership was reported and the previous claim noted.

The claim relationship

The taxpayer's submissions (supported by HMRC's published guidance at the time) was that there was a distinction between claims 'included in the return' and claims 'not included in the return'. The latter included carry-back loss claims, such as that made by Mr De Silva because it related to more than one year and the requirement to include it in a return was removed by TMA 1970, s 42(2).

Schedules 1A and 1B then provided a separate or parallel legislative system outside the self-assessment system for the making, giving effect to and enquiry into such claims. Consequently, it was the type of claim that determined the type of enquiry, not the other way around. HMRC was therefore required to challenge claims for the carry back of losses made outside a return solely through Sch 1A.

> ***"HMRC's argument in De Silva was that it was not restricted to Sch 1A when enquiring into such a claim."***

HMRC's argument in *De Silva* was that it was not restricted to Sch 1A when enquiring into such a claim. Not only must the loss be quantified in a subsequent return but, by necessity, so must the claim itself; notwithstanding it had already been made and effect given to it by HMRC.

The Supreme Court agreed with the taxpayer that 'claims for relief involving two or more years' (carry-back claims) are those not included in a return and come under Sch 1A. However, they are not claims solely governed by this provision and subsequently (assuming a claim has been made early) they are also claims 'included' in the return when the loss is reported in it. This 'second' claim then feeds into the self-assessment because the taxpayer must provide information as to the degree of offset sought in that year. Hence HMRC could either enquire into the 'first' claim under Sch 1A or into the return by enquiry under s 9A (or deemed enquiry under s 12AC) on the basis that the 'second' claim was included in the return reporting the loss.

Damage to the finality principle

However, in effect, the reasoning states that even though the taxpayer did not claim relief in the later year for the loss carried back they are deemed to be claiming relief in the later year because the repayment will be made in that later year, albeit by reference to the tax overpaid in the earlier year. In other words, the Supreme Court has held that something that did not happen is treated as having happened.

Further, the Supreme Court held that, if excessive relief had been given by an earlier claim, it was open to recover this error through increasing the self-assessment in the later year. Certainly, before the Supreme Court decision it was arguable that, if HMRC had made an earlier repayment, the only basis for recovery of the tax was by assessment. The decision of Lord Hodge indicates this view is now incorrect.

In terms of legal principles, the real casualty in all this is the notion of finality. The cornerstone of the self-assessment regime is certainty. HMRC has been given extensive powers of enquiry. If these actions are not carried out within the specified time frames or issued under the correct provisions the taxpayer has the right to rely on the TMA provisions for finality.

Having two systems for making claims and two for enquiry into such claims extends rather than restricts the scope of HMRC's powers. In the broad class of cases in which a claim might previously have been regarded as solely made outside a return, the finality principle remains only to the extent that HMRC chooses to allow it.

Conclusion

As a result of the decision, it is clear that:

- the distinction between claims included and claims not included in a return is not exclusive: there is a broad overlap between the two categories;
- an entry in a return that *could* affect the tax chargeable for a particular tax year *does* affect how much is chargeable;
- if HMRC does not achieve its aim by enquiring into the claim, it will always have the option of enquiring into the return.

Although there appears not to be an obvious silver lining to this case, it highlights the care that professional advisers need to take in reviewing current as well as historic loss claims, particularly as to whether the claim was included in the return in terms of the timing for enquiry purposes.

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