Tooth nails the meaning of 'deliberate' and eradicates 'staleness'

Tony Monger explains the implications of a Supreme Court ruling that found against HMRC, and also calls into question the taxman's behaviour in the case

The long-running saga of Raymond Tooth versus HMRC reached its conclusion in the Supreme Court recently when the Court dismissed the assessment that HMRC had made upon him.

The case has been keenly followed by tax professionals through the First Tier and Upper Tribunals and the Court of Appeal because it focused on two important principles – the question of what constitutes a deliberate inaccuracy in a return and the question of whether a 'discovery' can become 'stale'.

First Principles

The basis of the argument rests on two simple principles. The first is that, in order to make an assessment to tax for past years, it is necessary for an HMRC officer to 'discover' that tax has been underassessed for that year.

The second is that the number of years back that HMRC can then assess is determined by the 'behaviour' that gave rise to that underassessment. At any time HMRC can normally assess back four years. If the underassessment arises from careless behaviour, then that extends to six years; and if the behaviour is deliberate, then HMRC can assess back as many as 20 years.

This is all fairly straightforward but the other factor to consider is whether, after having discovered that tax has been under-assessed, HMRC is under some obligation to make an assessment quickly – or is it possible for the discovery to somehow lose its freshness and become stale? Or, in the jargon of the Courts, is a discovery invalidated as a result of staleness? This latter point is probably the easiest to answer.

Can a discovery become stale?

The concept of staleness in regard to a discovery has only been raised in the last decade. In the tax case of Pattullo v HMRC [2016] UKUT 270 (TCC) the Upper Tribunal held that a discovery can become stale, largely basing their view on the judgement in HMRC v Charlton Corfield & Corfield [2012] UKUT 770 (TCC) which defined a discovery as requiring "that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment" – the emphasis being on the term 'newly'.

This concept was followed in a number of other cases – notably Clive Beagles v HMRC [2018] UKUT 380 (TCC) and, more recently, Kashif Mehrban v HMRC [2021] UKFTT 0053 (TC) – which, frankly, presented HMRC with a number of problems. It is not unusual in enquiry cases for HMRC to hold off from making assessments until the very end of the enquiry, largely in hopes that they can encompass all of the liability to tax, interest and penalties in one all-embracing 'offer' from the taxpayer. This is a darn sight easier than making assessments and penalty determinations on every type of tax for every year – but if a discovery can become stale it might mean that, come the end of the enquiry (as in Mehrban), HMRC might have run out of time to assess.

The other issue arises with all of the information that HMRC receives year on year, be that from UK sources or from exchanges of information with other countries. At what stage could HMRC be said to have 'discovered' an underassessment – When they receive the information? To be fair to HMRC, they receive veritable Himalayan mountain ranges of information each year – but have barely enough staff to conquer Everest a few times a year. Would they be prevented from climbing K2 because it had taken them too long to find it?

Thankfully for HMRC, the Supreme Court has dismissed the entire idea of invalidity through staleness. They rejected the interpretation of 'newly appeared' in Charlton Corfield & Corfield and explained that the phrase referred to "…the state of mind of the person said to have made the discovery, to whom it "newly appears" that an assessment to tax is insufficient." The Court went on to say that "A discovery is a particular event in time and does not cease to be such with the passage of time."

As will be appreciated, the Supreme Court is the ultimate arbiter in these matters and these words kill the concept of a stale discovery stone dead.

The meaning of deliberate

If Mr Tooth's case had rested purely on the staleness argument, he would have lost. However, there was better news for him in the question regarding the meaning of 'deliberate'.

It needs be explained that the way in which HMRC was seeking to apply the legislation in this case was, one might say, pushing the envelope somewhat. Mr Tooth had subscribed to an avoidance scheme and had given full details of his involvement in his tax return, even going so far as to include a note in the White Space on the return that "I acknowledge that my interpretation of the

tax law applicable to the above transactions and the loss …may be at variance with that of HM Revenue and Customs. Further please note that …I wish to make it clear that the deduction I am claiming on my return is not what you regard as a Loss for this tax year set-off against other income for 2007-08 - for all these reasons I assume you will open an enquiry."

For reasons best known to themselves, HMRC did not open an enquiry into Mr Tooth's return using the provisions under section 9A TMA 1970 – the normal kind of enquiry that would be opened into a return – but instead opened an enquiry under Sch 1A TMA1970, which allows an enquiry to be made into a claim for relief. It took some years – in fact until July 2014 - for HMRC to realise that they had not opened the right kind of enquiry, by which time they were far too late to open a section 9A enquiry. Their only way to cover their mistake was to make a 'discovery' assessment on the grounds that they had discovered that tax had been underassessed.

However, this was when they hit their next problem. More than six years had passed since the end of the year so HMRC could only make a discovery assessment if they could say that the underassessment was due to a deliberate act. At some stage HMRC came up with what might be described by Baldrick of the Blackadder TV series as a cunning plan.

It so happened that when Mr Tooth had completed his return, a flaw in the return software meant that he was unable to enter his tax scheme loss in the box that would enable the scheme loss to impact on his tax computation. He was advised to put it in a different box but add a White Space note to explain what he had done. The problem was solved by entering the figure in a box for claiming partnership losses, even though Mr Tooth had not been a member of a partnership – but Mr Tooth explained all of this in his White Space disclosure.

When faced with the problem of needing a deliberate error in order to make a discovery assessment, it seems as though some genius in HMRC came up with the idea as follows: Mr Tooth has intentionally entered a figure in the wrong box. This is a deliberate inaccuracy in a return. And you can be penalized for deliberately submitting a tax return that you know contains an error. Ahah! We've got him!

Of course, Mr Tooth, his representatives and Counsel have all argued that his White Space disclosures, which were extensive, made it absolutely clear what he had done and why. There was clearly no intent on his part or that of his advisers to do anything other than to make absolutely clear to HMRC exactly what he was claiming. Among the responses from HMRC was the argument that, under self assessment, the processing of taxpayer's returns is done by computers that cannot understand the white space comments, so, if you claim a repayment that you aren't entitled to, the self assessment system will automatically grant it (unless, of course, HMRC has the intellect to open a Section 9A enquiry into a return…).

Thankfully, the Supreme Court gave HMRC's arguments short shrift. In terms of the question of a deliberate inaccuracy, the Court decreed "for there to be a deliberate inaccuracy in a document… there will have to be demonstrated an intention to mislead the Revenue on the part of the taxpayer as to the truth of the relevant statement". The quality and extent of Mr Tooth's White Space disclosure clearly showed that there had been no intention on his part to mislead HMRC.

The Supreme Court also had some pithy remarks to make regarding HMRC's argument that their computer couldn't read the White Space notes. The Judgement states:

"This is, with respect, a very unattractive argument. A document written in the English language (or any language other than computer language) does not have a different meaning depending upon whether it is read by a human being or by a computer. A choice by the recipient of such a document to have it machine-read cannot alter its meaning. Furthermore, the Revenue-approved online tax return form used by Mr Tooth and his advisors contained numerous "white spaces", that is, sections of blank white-coloured space, usually headed "Additional Information", within which the taxpayer is invited to add information using his own words and phrases, so as to ensure that the declaration required to be made and signed, namely that:

"The information I have given on this Tax Return is correct and complete to the best of my knowledge and belief" is actually true.

The Revenue cannot in our view have it both ways. If they sensibly include ample white spaces in their approved form of online returns so as to ensure that the taxpayer is not constrained by the limitations of the boxes for figures from making a correct and complete return, then they cannot thereafter assert, for the purpose of advancing a non-contextual interpretation of one or more boxes, that their computer cannot read what is written on the white spaces. This must be a fortiori true where, as in the present case, the white space used by Mr Tooth to provide a full and frank explanation of the true meaning of the supposedly offending insertions in the partnership boxes was to be found immediately adjacent to those boxes."

Judgements are rarely stated as clearly as that.

Where now?

The dismissal of the 'staleness' argument is no loss to the taxpayers and brings much welcome clarity to the much-and-oft-debated meaning of the term 'discovery'.

As for the term 'deliberate', taxpayers and the accountancy profession can breathe a sigh of relief that we have, in effect, returned to the previous understanding of its meaning as something requiring both knowledge and intention – in other words, that a taxpayer who commits a deliberate offence must both know that he is committing an offence and intend to mislead HMRC as to his conduct.

That all said, is there not a point to raise regarding HMRC's conduct in this case? When taxpayers and tax avoidance promoters have sought, as many have done, to push the tax envelope to get a – how can we put it? – contorted result, they have been rightly criticized for egregious behaviour. Indeed, a former HMRC chairman went so far as to describe some abusive schemes as "scams for scumbags". When HMRC tries something similar, should they not also be criticized?

As the Supreme Court remarks "…a 'deliberate inaccuracy' is the gateway to the taxpayer's exposure to a 20-year period for the making of a discovery assessment… If the interpretation [that a deliberate inaccuracy was nothing more than a deliberate statement which is (in fact) inaccurate] were to be preferred the taxpayer could incur that exposure by making an honest but in fact inaccurate statement, even after taking reasonable care as to its truth or falsehood. The taxpayer would not even need to be careless, and yet would incur a much longer exposure than if he had been." There but for the grace of the Supreme Court go us all.

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