Are protective assessments a back door to discovery?

Salman Anwar explains the key considerations for tax advisors dealing with a protective assessment

The end of the tax year sees a flurry of activity by advisers to ensure their clients have maximised the use of reliefs and allowances to ensure they mitigate the client's tax liabilities. But it is also an important time for HMRC as the deadline governs its ability to raise assessments for personal tax liabilities.

For companies that ability is governed by reference to the accounting period end.

In long-running investigations, or those in which HMRC suspects a loss of tax arises in a number of years, HMRC's ability to assess the tax liability can 'fall out of time'. Therefore, where HMRC has not definitively established all the facts but has strong suspicions of omissions it may issue what it commonly refers to as a 'protective assessment'.

In this article I look at what a protective assessment is, the conditions for HMRC issuing one, and key considerations that advisers need to bear in mind.

But first a cautionary tale

It is important to note that the conditions are clearly set out in law and whether they have been met or not will be a question of fact. While it is important for any adviser to maintain a degree of rapport and collaboration with HMRC during a, presumably, long running enquiry, it is imperative that the client's rights are protected at all times.

I was taught this very lesson by an adviser very early in my career as an investigator in HMRC's Fraud Investigation Service. The protective assessment was appealed and a request for a statutory review of the decision was requested. Strict time limits kick in at this point and the officer's ability to gather further information can be severely impacted. You'll need to read to the end of this article to find out how this story ends.

What is a protective assessment?

There is no such thing as a protective assessment in law! With that bombshell out the way, let's look at what powers HMRC uses to issue one.

A discovery assessment

HMRC can raise an assessment to recover a loss of tax under section 29 of the Taxes Management Act 1970 (TMA). These are commonly referred to as 'discovery powers' and the assessments as 'discovery assessments'.

These powers are only available if HMRC is out of time to open a statutory enquiry for the particular year, if a return was filed. For example, HMRC open an enquiry into a taxpayer's 2020/21 tax return within the statutory deadline. However, in February 2023 HMRC discover that a property disposal falling in the 2016/17 tax year was omitted from the return for that year. HMRC cannot open a statutory enquiry into the tax return for 2016/17 as the deadline for doing so will have long expired and, therefore, need to rely on its discovery powers to be able to pursue any tax liability associated with the disposal.

Where a taxpayer has failed to notify their chargeability to tax and, therefore, not submitted a tax return for the year in question, HMRC has a less restrictions placed upon its ability to exercise discovery powers. This is because the specific conditions restricting use of these powers for instances where a return has been made and delivered to HMRC do not apply. Generally, HMRC will have 20 years to raise an assessment unless the taxpayer can demonstrate they had a reasonable excuse for their failure.

Further conditions

Broadly, the power is predicated on HMRC discovering that any income or capital gains, which ought to have been assessed to tax have not been assessed. There are several restrictions and conditions on the exercise of this power where a return has been submitted to HMRC. These include:

- The loss of tax discovered was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.
- The return was made and delivered in line with practice generally prevailing at the time it was made.
- At the time the relevant enquiry time limit expired, or such time as when a partial or final closure notice was issued, 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 loss of tax.

I will not go into the definition of 'information made available' for the purposes of this article as it can be a vast topic in and of itself. Depending on the circumstances, the conditions mentioned above may be mutually exclusive.

In my example above, HMRC will likely fulfil the condition noted at the first bullet point.

How long does HMRC have to issue a discovery assessment?

Subject to fulfilling the relevant conditions and based on the nature of the underlying offence giving rise to the error, HMRC has four, six, 12 or 20 years from the end of the tax year to which the error/omission relates.

In my example above, HMRC will need to raise an assessment by 5 April 2023 (six years) if the 2016/17 omission was a result of careless behaviour by the taxpayer or someone acting on their behalf. If HMRC has not established all of the facts (for example, availability of Private Residence Relief and/or why the disposal was not reported), it may need to 'protect' its ability to pursue the tax and, therefore, may have issued a protective assessment by 5 April 2023.

Appeal and review rights

As well as having the right to appeal the assessment, the client also has the right to ask for a statutory review of the decision by another HMRC officer. These are commonly referred to as independent reviews by some practitioners.

A review of the decision can be requested at the same time an appeal is made against the assessment, at a later date after an appeal had been made but not settled, or an offer of a review may be made by HMRC at such a time as any further discussions are deemed to be unnecessary or not likely to lead to progress.

The client can also choose to notify the appeal to the tribunal. Unless otherwise agreed with HMRC, there are strict statutory time limits for the various stages of an appeal.

Protective assessments in practice

HMRC will usually inform the adviser of the need to issue a protective assessment in advance of the tax year ending. In some cases this may be many months in advance and in others it could be last minute. It depends on the nature of the case, how apparent is the need to go back to earlier years, experience or lack thereof of the HMRC officer, amongst many other factors.

Where HMRC opens early dialogue on the need to protect its position it will seek agreement/buy-in of the adviser and taxpayer. In most cases it will also invite an appeal against the assessment as well as an application for postponement of some or all of the tax due.

For the vast majority of cases the appeal and postponement application are accepted, with the appeal being stood over pending the outcome of the investigation.

What should I do if my client receives a protective assessment?

Hopefully, you will have had an open dialogue with the officer prior to it being issued. However, it is important to critically evaluate whether the conditions have been fulfilled for HMRC to have issued a discovery assessment.

As mentioned at the start of this article, it is highly advisable to evaluate whether the relevant conditions have been met by HMRC. In my cautionary tale, I was not able to demonstrate that the behaviour condition had been met and, therefore, I was out of time to raise the assessment, protective or otherwise was not of relevance.

I was not able to demonstrate to the satisfaction of the review officer that the error was careless or deliberate and my assessment was cancelled. A case that could have run for an extended period of time was concluded within six months due to the adviser knowing the law and challenging, well within their rights, HMRC's application of it.

Similarly, in the example I gave earlier in this article, it will be important to challenge and establish whether HMRC had fulfilled the relevant condition when it raised the protective assessment.

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