Briefing

Private client review for June

Speed read

Discovery assessments continue to provide tax headlines. This month, we look at two cases regarding the validity of discovery assessments: a win for HMRC in *Martino* in the wake of the Supreme Court's decision on staleness, whilst the taxpayer wins in *McCumiskey*. In *Lowe*, the tribunal examined the meaning of 'on his behalf' in the context of allowable expenditure for CGT purposes. Finally, there is partial success for the taxpayers in two cases dealing with the validity of information notices: *Wiseman* is a reminder of the limits of legal professional privilege, and *Hackmey* demonstrates that objective reasonable belief, rather than mere subjective suspicion, is required for raising information notices.

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Staleness in the post-*Tooth* era: HMRC discovery upheld

The practical impact of the Supreme Court's decision in *HMRC v Tooth* [2021] UKSC 17 continues to be felt, with the rejection of staleness as a defence to discovery assessments resulting in another win for HMRC.

Following HMRC's successful appeal to the Upper Tribunal (UT) in *Hargreaves v HMRC* [2022] UKUT 34 (TCC) (discussed here in April), HMRC has again succeeded in the recent case of *HMRC v Martino* [2022] UKUT 128 (TCC) in overturning an FTT decision that a discovery assessment was invalid for staleness.

The case concerned withdrawals made in 2010 from a registered pension scheme of which Mr Martino was a beneficiary. In 2014, HMRC sought to tax the withdrawals on the basis that they were 'unauthorised payments'. HMRC made a discovery assessment against Mr Martino to this effect.

Mr Martino appealed to the FTT, challenging the discovery assessment on a number of technical grounds, including staleness (on the basis that HMRC made the assessment in May 2014 despite having been aware of the unauthorised payments since mid-2011). The FTT had found in Mr Martino's favour on staleness, though rejected the other technical challenges.

HMRC appealed to the UT and, following a stay to allow *Tooth* to be heard, the UT found in HMRC's favour. Given that staleness is no longer a defence, and given the lack of any other defects in the discovery assessment issued against Mr Martino, the assessment was held to be valid.

Notably, the UTT did not see any need to reopen the FTT's decision on the other technical grounds raised by Mr Martino and did not depart from the conclusions reached. The UT pointed to Mr Martino's failure to engage with the appeal (he was ultimately barred from participating) as the reason for this, but this might also be seen as a tacit endorsement of the approach in *Hargreaves* where the UT rejected an argument by the taxpayer that the FTT's discussion of 'non-staleness' arguments was merely *obiter*. Instead, discussion of the other arguments was a key part of the factual decision, making it more difficult to re-open on appeal to the UT. Other taxpayers might therefore struggle in staleness cases if other grounds of challenge have already been dismissed by the FTT.

Agency and fraud: taxpayer overturns discovery assessment

The FTT's recent decision in *McCumiskey v HMRC* [2022] UKFTT 128 (TC) provides a notable contrast to recent HMRC victories in respect of the validity of discovery assessments, with the FTT not only rejecting the validity of a discovery assessment but also suggesting that HMRC were partly to blame for the loss of tax in question.

Mr McCumiskey had engaged a professional tax agent to prepare his self-assessment return for 2015/16. Unbeknownst to him, however, a company connected with the agent filed the return and included a fraudulent claim for seed enterprise investment scheme (SEIS) relief. Mr McCumiskey was not aware of SEIS, had not made any qualifying investment, and had not reviewed or signed the return.

HMRC later enquired into the SEIS claim, making a discovery assessment against Mr McCumiskey. The case turned on whether the discovery assessment was valid, either on the grounds that the loss of tax was brought about carelessly or deliberately by a person acting on Mr McCumiskey's behalf, or that the HMRC officer could not have reasonably been expected to be aware of the situation given the information made available to them. Both require a return to have been filed by the taxpayer (or on their behalf).

The FTT found in Mr McCumiskey's favour. Mr McCumiskey was not aware of the company's involvement; it was not, therefore, acting as his agent. On this basis, the return had not been filed on Mr McCumiskey's behalf and the discovery assessment was not valid on either of the grounds put forward by HMRC.

In reaching this decision, the FTT was, unsurprisingly, sympathetic to Mr McCumiskey's personal circumstances (he was unfamiliar with the self-assessment process and was dealing with financial and health issues at the time). Notably, the FTT also suggested that HMRC should have subjected the SEIS claim to more scrutiny during the initial enquiry window, particularly given that Mr McCumiskey's profile did not fit that of a usual SEIS investor, going so far as to say the lost tax was facilitated by HMRC's policy of 'paying now and checking later'. It remains to be seen whether the FTT will adopt a similar approach in other cases, pushing HMRC to rely less on delayed discovery assessments.

CGT computations: expenditure incurred 'by or on behalf of' the taxpayer

In the recent case of *Lowe and another v HMRC* [2022] UKUT 84 (TCC), the UT examined the meaning of 'on his behalf' in the context of allowable expenditure for the purpose of a CGT calculation.

Mr Lowe had purchased a property in Sheffield around 40 years ago, with building works subsequently carried out on the property. TCGA 1992 s 38(1)(b) provides that, in computing the taxable gain accruing to a person on the disposal of an asset, sums may be deducted from the consideration amount, including 'the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset'.

When Mr Lowe sold his interest in the property in 2007, in calculating the CGT due, he sought to deduct the expenditure incurred on the building works, in accordance with s 38(1)(b). However, difficulty arose because his evidence as to the nature and cost of the building works consisted of quotes from builders (mostly addressed to Mr Lowe personally) and invoices from builders (mostly addressed to a company controlled by Mr Lowe and his business partner). Mr Lowe put forward various arguments in support of his submission that all of the building costs had been incurred 'by or on his behalf', even where the invoices were addressed to the company. However, these points were rejected, with the UT confirming that the phrase 'on his behalf' should be given 'its ordinary and natural meaning of connoting a relationship of agency' and concluding that there was no such agency relationship between Mr Lowe and the company. Accordingly, the FTT's decision – that where a quote or invoice was addressed to the company (which may have had a corporation tax benefit at the time), such expenditure could not be deducted by Mr Lowe in his CGT computation – stood.

In recent months, we have commented on other cases (*Rawlings and another v HMRC* [2022] UKFTT 32 (TC), in March, and *McEnroe and another v HMRC* [2022] UKFTT 113 (TC), in May) where the CGT charge on the disposal of an asset did not reflect the true economic outcome of the transaction. Similarly, this case reminds us that CGT is calculated in a mechanistic way and it is therefore essential that taxpayers structure payments in line with the relevant statutory provisions to ensure that their final CGT bill reflects the actual gain. Furthermore, retaining records of all such payments – to prove compliance with the legislation – is vital.

Information notices and legal privilege

The Supreme Court confirmed with some reluctance in *R (oao Prudential Plc) v Special Commissioner of Income Tax* [2013] UKSC 1 that legal professional privilege (LPP) does not extend to professionals other than a qualified lawyer. However, the FTT's recent decision in *Wiseman v HMRC* [2022] UKFTT 75 (TC) reminds us that lawyers should not assume that LPP applies to all communications with clients.

HMRC had issued an information notice under FA 2008 Sch 36 to Mr Wiseman, requiring him to disclose certain documents to enable HMRC to review his tax position for the 2002/03 tax year. Mr Wiseman appealed against the notice on the basis that the documents were subject to LPP because they related to communications between lawyer and client. HMRC took the view that any documents that would not usually be subject to privilege (i.e. accountancy advice and financial records) should not be subject to LPP simply because they were provided to Mr Wiseman by his solicitors.

The FTT noted that, whilst communications between lawyers 'acting in their professional capacity' and clients are generally privileged, one must consider: (a) whether such communications are part of the necessary exchange of information in the 'continuum of communication and meetings between the solicitor and the client'; and (b) the purpose of the communications, namely whether the 'dominant purpose' was the seeking or receiving of legal advice.

On this basis, the FTT concluded that, out of 12 classes of documents requested by HMRC, two were not protected by LPP (because the 'dominant purpose' was not the provision of legal advice) and were, therefore, disclosable to HMRC.

This decision serves as a pertinent reminder of the limits of LPP.

Information notices: reasonably required or HMRC 'fishing'?

The FTT's recent decision in *Hackmey v HMRC* [2022] UKFTT 160 (TC) reminds us of the hurdles that HMRC must navigate when attempting to enforce information notices.

Mr Hackmey had been UK resident since 2007, but was non-UK domiciled and a remittance basis user. His UK tax returns reported that his only taxable income was UK bank interest. However, he bought a home in 2013 for £9.7m, paying £679,000 of SDLT on the purchase. The inconsistency between Mr Hackmey's lifestyle and declared income led HMRC to suspect him of tax fraud. In September 2018, HMRC issued an information notice under FA 2008 Sch 36, requiring Mr Hackmey to provide information and documents relating to bank accounts, credit cards, funds remitted to the UK, gifts received and his connections to various trust structures.

In assessing the validity of the information notice, the FTT noted that (i) 'the information and documents sought by the notice must be 'reasonably required' by HMRC for the purposes of checking Mr Hackmey's tax position', and (ii) since Mr Hackmey had already filed tax returns for the relevant tax years, an HMRC officer must also have 'reason to suspect' that he had not been assessed to sufficient tax. It was accepted that the burden of proof rested on HMRC to show that these requirements had been met.

In relation to the first requirement, the FTT confirmed that 'a mere desire for background information is insufficient to justify the issue of a notice – that would amount to "fishing"'. As for the second requirement, the FTT noted that, whilst there is a low bar for an HMRC officer to have 'reason to suspect', the suspicion must have an objective basis.

Applying this to the facts of the case, the FTT partially quashed the information notice. Despite initial suspicions of fraud, HMRC now accepted that Mr Hackmey was funded by cash gifts from his wealthy father and so the focus of their investigation had changed. However, whilst the FTT accepted that HMRC might still have reasonable grounds to suspect that Mr Hackmey may not have declared all of his taxable income, it had failed to 'link the documents and information they require to their reasonable suspicions'. Certain documents were requested because it was 'usual practice' but this was not a reasonable basis for seeking such documents: 'there has to be evidence to support HMRC's submissions, and HMRC must demonstrate why they required the information.'

However, the FTT upheld part of the notice requesting details of offshore trusts of which Mr Hackmey was a beneficiary. HMRC already had some knowledge of the trusts and it was therefore 'reasonable' for HMRC to gather information relating to those trusts and any others which may be connected with property in the UK.

Hackmey reminds us that objective reasonable belief trumps mere subjective suspicion when it comes to information notices. Where taxpayers receive an information notice, their advisers would do well to consider whether HMRC is entitled to the documents requested or whether they are on a fishing expedition. ■

For related reading visit www.taxjournal.com

- Discovery following *Tooth*: what should advisers do now? (H Adams, 8.6.21)
- Cases: *S McCumiskey v HMRC* (5.5.22)
- Legal professional privilege in a tax context (I Hyde & M Greene, 9.9.21)