Analysis

Full proof: more needed from HMRC to discharge their burden of proof

Speed read

HMRC have extensive powers to assist them in the collection and management of revenue, including the ability to issue information notices, discovery assessments and penalties. However, HMRC must meet relevant conditions before exercising these powers and they also have the burden of showing they have met these conditions. Recent cases have warned that HMRC must take this burden seriously and it is important that taxpayers are aware of the issues that have arisen.

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Dealing with an HMRC enquiry or investigation is frequently a stressful and time-consuming exercise. HMRC have wide-ranging powers to require large amounts of information and documents, and they can continue with these enquiries for many years.

However, while HMRC's powers are extensive, they are not unlimited. HMRC can only require information that is reasonably required to check the taxpayer's tax position. HMRC must close an enquiry upon application unless they can show reasonable grounds for keeping it open and, when it comes to discovery assessments and penalties, HMRC need to meet certain conditions before they can be issued.

It is important for taxpayers to know how these conditions work, but an area that is less explored is the fact that the burden of proof to *demonstrate* that these conditions apply lies with HMRC. That may be because HMRC (and taxpayers) are so used to the fact that when contesting any substantive appeal, it is typically the taxpayer that must show why HMRC's conclusion is incorrect.

Recent cases in the First-tier Tribunal (FTT) have shown that a failure to take the burden of proof seriously can have serious ramifications for HMRC. In particular, a hard line has been taken where HMRC are seen as trying to shift their burden to the taxpayer.

Taxpayer information notices

HMRC's power to require taxpayers to provide them with information and documents is engaged when one of the relevant conditions in FA 2008 Sch 36 para 21 is met. Usually, HMRC will rely on the fact that they have an open enquiry or (whether or not there is an enquiry) that they have reason to suspect a loss of tax. However, it is not the case that HMRC can ask for any information or document that they want: the information must be reasonably required to check the taxpayer's tax position.

Despite some conflicting case law, it is generally accepted that HMRC have the burden of showing that the information they are seeking is reasonably required. This was certainly the position taken by the FTT in *Parker Hannifin (GB) Ltd v HMRC* [2023] UKFTT 971 (TC).

In this case, HMRC issued a Sch 36 information notice (the 'Notice') which required the appellant to carry out an email search using a list of specified terms. The taxpayer's representative, PricewaterhouseCoopers (PwC), carried out a slightly modified search, which identified 11,162 documents. PwC then performed reviews to remove those documents which they determined were not relevant to the issues under enquiry.

HMRC were not satisfied with the resulting 1,695 documents they were provided with, and they argued that the taxpayer was required to disclose all 11,162 documents.

Parker Hannifin appealed the notice, and one of the grounds of appeal was that the 'irrelevant' documents were not reasonably required. HMRC submitted that it was not open to a taxpayer to appeal on the basis that documents resulting from a search were not reasonably required; they contended that a taxpayer *only* has a right to appeal against the search terms themselves, and the burden lies with the taxpayer to suggest alternative search terms.

The FTT 'had no hesitation in rejecting [HMRC's] submission' and noted that to require the taxpayer to suggest amended terms would:

'(a) undermine the taxpayer's well-established right to appeal against a Notice on the basis that a document is not reasonably required;

(b) constitute an unjustified and unreasonable expansion of HMRC's right to access documents; and

(c) place an unfair and unreasonable burden on the taxpayer to correct the mechanism chosen by HMRC themselves to describe the documents required under the Notice.'

Having determined that the taxpayer had a right to appeal on the grounds the 'irrelevant' documents were not reasonably required, the burden was on HMRC to show that they were. HMRC were unable to discharge this burden, with the FTT finding that none of the documents were reasonably required and that certain requests constituted a 'fishing expedition'.

Dealing with enquiries

It is not unusual for HMRC to request large numbers of documents during an enquiry, but a request for all emails from certain months or years is rarely justified. For this reason, using keyword searches is a sensible way to identify relevant documents. However, as *Parker Hannifin* makes clear, keyword searches only identify *possible* relevant documents. They are not perfect and will usually end up identifying irrelevant and privileged documents as well.

As in *Parker Hannifin*, HMRC may suggest that taxpayers should simply provide documents, without acknowledging concerns that such disclosure could include documents that are irrelevant, privileged or otherwise sensitive. HMRC promote transparent engagement and will threaten penalties for perceived non-compliance. There is nothing wrong with that and cooperation is to be encouraged, but it does not mean HMRC can ignore their obligations or taxpayers' rights. That is exactly the shift in responsibility that *Parker Hannifin* criticised.

If taxpayers are faced with requests for unfiltered emails or impractical keyword searches, they are entitled to push back. Keywords should be chosen carefully so that the right balance is struck between identifying relevant documents

without including excessive numbers of irrelevant documents. Taxpayers are similarly entitled to review the results to ensure only appropriate documentation is provided. In doing so, taxpayers should ensure that their review process is objectively reasonable, well-documented and can be explained to HMRC.

Parker Hannifin emphasises that, where information sought by HMRC goes beyond what is proposed by the taxpayer, the burden is on HMRC to show that the information they are seeking is reasonably required (and that they are not on a fishing expedition).

Sensible engagement with HMRC is important and most enquiries are rightly conducted in a spirit of cooperation. If, however, taxpayers are faced with requests that they consider are not relevant to their tax position and HMRC do not justify their approach, they should call on HMRC to explain.

Discovery assessments and penalties

Where a return has been filed, HMRC can issue a discovery assessment if they have discovered a loss of tax and can show either: (i) the loss of tax is brought about carelessly or deliberately; or (ii) the officer could not have been reasonably expected (at the time when the officer ceased to be entitled to enquire) to be aware of the loss of tax on the basis of the information available (the 'hypothetical officer condition') (TMA 1970 s 29 and s 30B, and FA 1998 Sch 18 paras 43–44 for income tax, partnerships and corporation tax respectively).

The situation is similar when it comes to penalties for inaccuracies in documents given to HMRC under FA 2007 Sch 24. HMRC can only issue penalties where the inaccuracy is careless or deliberate.

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In each case, the burden is on HMRC to show that they have met the necessary conditions to issue discovery assessments and penalties, as illustrated in the recent cases of *Boston Consulting Group UK LLP and others v HMRC* [2024] UKFTT 84 (TC) and *Thompson v HMRC* [2024] UKFTT 138 (TC).

Boston Consulting Group involved various substantive and procedural issues. One of these was a challenge by the members to the validity of discovery assessments on the basis that the hypothetical officer condition was not met.

The FTT noted that the focus of the test is on the quality of the taxpayer's disclosure and whether it alerts the hypothetical officer to the insufficiency in the assessment or return. However, the burden rested on HMRC to show what information was made available to the hypothetical officer, and to explain why this information was insufficient in alerting them of the loss of tax.

The FTT observed that 'HMRC has done remarkably little to make their case' and 'have not explained what information was provided which would have made clear to HMRC that the receipts were income. Clearly this is failing to recognise where the burden of proof lies.' The FTT agreed that it was 'not enough for HMRC to merely assert that the test is met without proper reference to, and analysis of, the relevant documents. There is very little engagement in HMRC's case with the position regarding the "disposal" assessments.' The tone of the judgment is unusually firm, emphasising that the FTT clearly felt HMRC needed to take their responsibilities more seriously.

Thompson v HMRC concerned an appeal of a penalty issued by HMRC for an inaccuracy in the appellant's return, as a result of failing to declare two sources of income. HMRC's primary case was that the inaccuracy was deliberate (but not concealed).

The FTT began their consideration in terms that suggest some of the frustration that was reflected in the *Boston Consulting* case: 'We remind ourselves (and indeed HMRC) that it is for HMRC to establish deliberate or careless behaviour, and it is not for the appellant to establish that he has not behaved deliberately or carelessly.'

The FTT noted the serious nature of an allegation of deliberate behaviour (tantamount to fraud) and referred to the finding of the Supreme Court in *HMRC v Tooth* [2021] 1 WLR 2811 at [47] that it requires 'an intention to mislead the Revenue on the part of the taxpayer as to the truth of the relevant statement'.

Despite the seriousness of this issue, the height of HMRC's case on deliberate behaviour was that the appellant must have deliberately not told his agent about the income, as they would have included it in the return if they were aware. HMRC did not provide further evidence to support this argument and did not challenge the appellant's evidence that he had told his agent about the income.

The effect of HMRC's argument was to create a presumption of deliberate behaviour that would be up to the taxpayer to overturn. The FTT rejected that approach.

Dealing with questions of behaviour

For most of the procedural conditions that HMRC must satisfy (including the hypothetical officer condition), HMRC do not need additional information from the taxpayer. By contrast, HMRC will often need further information from the taxpayer to determine questions concerning their careless or deliberate behaviour.

This means taxpayers can be faced with requests for information on advice they have received, and asked to explain how their behaviour was that of a reasonable taxpayer. Such questions may feel as if the burden is being put on the taxpayer, but once HMRC have gathered the information, it is for HMRC to prove that it supports careless or deliberate behaviour on the part of the taxpayer. Only once HMRC have satisfied that burden will it be for the taxpayer to attempt to rebut HMRC's view. That means that taxpayers need to consider carefully what evidence they can provide because it will be used both to support HMRC's position and to justify their own.

Conclusion

It is encouraging to see the FTT dealing robustly with situations where HMRC either do not appreciate that the burden is on them or what they are required to show to satisfy that burden.

Hopefully these decisions will have an impact on how HMRC conduct enquiries and make decisions. However, it is important that taxpayers are aware of these issues in order to hold HMRC to account where appropriate. ■

The author thanks Blaise Kingan of Macfarlanes for her contribution to this article.

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- Cases: *Parker Hannifin (GB) Ltd v HMRC* (29.11.23)
- Cases: *Boston Consulting Group UK LLP and others v HMRC* (5.2.24)
- Cases: *S Thompson v HMRC* (27.2.24)