TC02768

Appeal number: TC/2011/1648

INCOME TAX – discovery assessment – s 29 TMA 1970 – validity of assessment – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR ROBERT SMITH **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE PETER KEMPSTER
MRS MARYVONNE HANDS

Sitting in public at Priory Courts, Birmingham on 22 & 23 November 2012

Mr Gary Bell QC, instructed by Salhan Accountants Limited, for the Appellant

Mr Oliver Conolly of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The Appellant ("Mr Smith") appeals against a discovery assessment issued by the Respondents ("HMRC") on 29 November 2006 in respect of the tax year 2000-01, on the grounds that the assessment was not validly made.

Facts

2. In 2000-01 Mr Smith participated in a marketed tax avoidance scheme designed to create a tax deductible capital loss of £532,695. Mr Smith accepts that, as a result of the Court of Appeal decision in *Drummond v HMRC* [2009] STC 2206, the scheme, which involved the acquisition and disposal of second-hand insurance bonds, did not achieve its purpose.

3. Mr Smith's self-assessment tax return for the tax year 2000-01 ("the Return") was submitted on 22 January 2002. It is accepted that some details on the Return were incorrect – for example, the date of disposal of the bonds – but that is not material to the appeal. The Return gave two "white space" disclosures as follows.

> "During the period Mr Smith acquired a non-qualifying second hand insurance bond for £532,695. This bond was subsequently redeemed in full, on 6 March 2001 for an amount of £483,228.93.
>
> For tax purposes the surrender proceeds fall to be taxed under both s.54 1TA 1988 (income) and s.22 TCGA 1992 (capital gains).
>
> For income purposes a charge arises equal to the excess of surrender proceeds over premiums paid into the policy. In the case of Mr Smith the income arising is:
>
> | | £ |
> |---|---|
> | Proceeds received on surrender | 483,228.93 |
> | Premiums paid into the policy | (510,000.00) |
> | Income Charge | NIL |
>
> Please refer to the additional disclosure on schedule CG7 for details of the capital gains position."
>
> "In calculating the capital gain arising on the final surrender the proceeds are again the amount received on surrender. However, s.37 TCGA 1992 provides that sale proceeds which have been taken into account for income purposes should not be taken into account for capital gains purposes. As the proceeds of £483,228.93 have been taken into account above in calculating the chargeable event gain, the proceeds for capital gains tax purposes are.-
>
> | | £ |
> |---|---|
> | Proceeds received on surrender | 483,228.93 |
> | Less amounts excluded under s.37 TCGA 1992 | (483,228.93) |
> | Proceeds for capital gains purposes | NIL |

The expenditure incurred for capital gains purposes is the amount paid by Mr Smith for the bond i.e. £532,695.

The capital gains tax computation on surrender of the bond is:

	£
Sale proceeds (as above)	0
Allowable expenditure (as above)	(532,695)
Capital gain/(loss)	(532,695)"

4. On 15 July 2002 a message ("the Newsboard Message") was posted on HMRC's "Newsboard" (an intranet accessible by all HMRC staff) by Mr Cass, an Inspector in HMRC's Capital Taxes Technical Group:

> "**Avoidance: Capital Losses from 2nd Hand Life Assurance Policies: 05/02/PM**
>
> *To: Area Directors and staff reviewing ITSA Returns*
>
> We are aware of a capital loss avoidance scheme using second hand life assurance policies. Typically a taxpayer purchases a second hand non-qualifying policy and redeems it a few days later, often for a little less than he paid. You can identify cases from the losses section on pages CG2 and CG3 of the return. The description of the asset may include the name of an insurance company and refer to the asset being a 'bond' or 'policy'. The type of disposal will be 'O'. There will be no disposal proceeds and a large capital loss - in the cases we have heard about from £100,000 to £1,000,000 with almost all the losses being set against capital gains in the same year.
>
> If you identify any cases where it seems these arrangements have been used will you please let David Cass at Capital & Savings in Solihull [telephone number] have the following details:
>
> 1. The names of the taxpayer and any agent acting.
> 2. When the policy was redeemed and the amount of the loss claimed.
> 3. Approximately how much more CGT would have been due if there was no loss.
> 4. Which tax office deals with the taxpayer's return.
>
> The tax consequences of the transactions may be twofold. To the extent that the disposal proceeds exceed the premium paid when the policy was taken out, a small chargeable event gain will arise on which income tax at the higher rate may be due. And a capital loss equal to the amount paid for the second hand policy is claimed. This is on the basis that all the disposal proceeds have been taken into account in arriving at the chargeable event gain liable to income tax so the only figure in the capital loss calculation is the price paid for the second hand policy, which doesn't feature in the calculation of the chargeable event gain. We are considering the best approach to challenging these

claims. If you have an open enquiry and want more information please contact David Cass."

5. On 13 September 2002 Mr Hiron – the local Inspector dealing with Mr Smith's file – spoke to Mr Cass on the telephone. The call was prompted by the Newsboard Message and Mr Hiron's note records:

> "Gave details of this case [ie Mr Smith] and agreed to follow the same process as in the case of [Miss X – another taxpayer].
>
> In short - delay any enquiry until (say) December and, if no Newsboard Message meantime, get back to David Cass for instructions and advice about what detail should be requested."

6. On 21 November 2002 Mr Cass wrote to Mr Hiron concerning Mr Smith (and also Miss X):

> "I refer to [the Newsboard Message] about which you contacted me earlier this year. We have now been able to finalise our thoughts on how the artificial losses being created with second hand life assurance policies by taxpayers such as yours may possibly be challenged. I attach a copy of my paper on this topic for your information."

7. The paper attached to the letter ("the Cass Memo") was four pages long and gave a technical analysis of how the scheme was designed to work, "possible counters", and instructions on "taking cases forward". It included the following:

> "2.5 Before putting forward any technical arguments along the lines described in 2.2 and 2.3 it is essential that you obtain <u>all</u> the facts and evidence. Some of these cases might be sufficiently serious for colleagues in SCO [Special Compliance Office] to become involved. The following are some of the details and questions that SCO might want to ask, although third party information powers may have to be used to obtain information and documents' not actually in the power or possession of the taxpayer: [list of 12 categories of information]
>
> (Please do <u>not</u> simply use this list verbatim but tailor it to the facts of your case and put any of the questions you decide to pose in your own words and in the order that seems best to you.)
>
> **Taking cases forward**
>
> 3.1 If you decide to open or take forward an enquiry into the losses claimed by your taxpayer would you please let me have a brief report if you are successful in disallowing all or part of the losses claimed.
>
> 3.2 If you cannot settle your enquiry by agreement and feel that your case is strong enough to warrant amending your taxpayer's return with a view to taking an appeal before the Commissioners, would you please let me see your papers before you actually amend the return. Please let me have your draft of the skeleton argument you would put before the Commissioners at any appeal hearing. (Remember that a submission under IM4940 is mandatory before any contentious appeal is listed for hearing by the Special Commissioners.)

> 3.3 If you come across any more of these cases please remember to let me have the information I asked for in IR Newsboard Message 058/02."

8. The normal enquiry window provided by s 9A Taxes Management Act 1970 closed on 31 January 2003. No s 9A enquiry was opened by HMRC.

9. On the letter dated 21 November 2002 (see [6] above) filed on Mr Smith's file was a handwritten note by Mr Hiron:

> "Tony Hiron on sick leave 21/11/02 to 3/3/03. No action during that period and therefore SA window for Enquiry already closed 31/1/03. Too late!"

10. On 18 March 2004 there was an internal email between two officers in Special Compliance Office attempting to locate Mr Smith's "2001 enquiry papers", and annotated "No enquirys [*sic*] taken up". On 22 March 2004 the Return was forwarded to SCO internally.

11. On 9 March 2006 Special Civil Investigations (successor to SCO) wrote to Mr Smith concerning the scheme and stated:

> "Officers from Special Civil Investigations ('SCI') Bristol are responsible for co-ordinating the H M Revenue & Customs ('HMRC') response to the tax mitigation arrangements involving second hand life insurance policies. I am writing to let you know the current position in relation to the scheme.
>
> Legislation at S157 Finance Act 2003 was enacted to counter the arrangements, and is effective from 9 April 2003. However, that change does not mean that HMRC accept such arrangements worked prior to the date on which the new legislation came into effect.
>
> It is likely that you will have been asked to provide documents and information, either by officers from SCI (formerly Special Compliance Office) or by your own tax office. In some cases, correspondence regarding documents and information may be ongoing. This will be the case where, for instance, experience suggests that more documents than have been supplied to HMRC are likely to have been produced in respect of the arrangements.
>
> Documents and information for a select number of users have been examined in detail by our technical experts and lawyers in order to determine the HMRC response: The advice we have been given is that the scheme is technically flawed and does not work. HMRC is therefore preparing to litigate selected cases. We expect the outcome of those cases to resolve the outstanding issues for the vast majority of those who used the scheme.
>
> You should be aware that resolution of issues through litigation will take some time. Should the arrangements prove to be ineffective then HMRC will seek from you the full amount of tax together with interest due for late payment.
>
> …

> It is, of course, open to you to settle the matter with HMRC on the basis that you pay the full amount of duties that would be payable assuming the arrangements do not work, plus interest for late payment."

12. On 8 November 2006 SCI wrote to Mr Smith's accountants stating:

> "I have been reviewing your client's tax return for the year 2000/01 in connection with the capital loss claimed in connection with the surrender [of] a second hand insurance bond.
>
> You will be aware that a SHIPs scheme was actively being promoted by your predecessor firm, HLB Kidsons, at this time.
>
> It is our view, following advice from Counsel that the use of SHIPs to create capital losses where no genuine proportionate economic loss resulted does not achieve its objective.
>
> Following the case of Langham v Valtema, heard by the Court of Appeal in 2004, I am raising a discovery assessment against your client as I do not believe any capital loss arises on the disposal of the second hand insurance bond and that nothing in the return precludes me from making such an assessment.
>
> The assessment will be raised in the next 3 weeks to give you time to forewarn your client that an assessment is being made."

13. On 29 November 2006 a discovery assessment was raised in the amount of £159,808.40 ("the Assessment"). The accountants lodged an appeal with HMRC on 22 December 2006. There was various correspondence and on 26 January 2011 HMRC issued the result of their formal internal review, confirming their view that the Assessment had been raised validly under s 29 TMA 1970. On 25 February 2011 a notice of appeal to the Tribunal was filed, and the appeal now comes before us.

Law

14. Section 29 Taxes Management Act 1970 as in force at the relevant time provided:

> "**29 Assessment where loss of tax discovered**
>
> (1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment—
>
> (*a*) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
>
> (*b*) that an assessment to tax is or has become insufficient, or
>
> (*c*) that any relief which has been given is or has become excessive,
>
> the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

(2) Where—

(*a*) the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, and

(*b*) the situation mentioned in subsection (1) above is attributable to an error or mistake in the return as to the basis on which his liability ought to have been computed,

the taxpayer shall not be assessed under that subsection in respect of the year of assessment there mentioned if the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—

(*a*) in respect of the year of assessment mentioned in that subsection; and

(*b*) in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

(4) The first condition is that the situation mentioned in subsection (1) above is attributable to fraudulent or negligent conduct on the part of the taxpayer or a person acting on his behalf.

(5) The second condition is that at the time when an officer of the Board—

(*a*) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or

(*b*) informed the taxpayer that he had completed his enquiries into that return,

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 situation mentioned in subsection (1) above.

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if—

(*a*) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(*b*) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(*c*) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to

the officer, whether in pursuance of a notice under section 19A of this Act or otherwise; or

(*d*) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above—

(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (*a*) to (*c*) above; or

(ii) are notified in writing by the taxpayer to an officer of the Board.

(7) In subsection (6) above—

(*a*) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes—

(i) a reference to any return of his under that section for either of the two immediately preceding chargeable periods; and

(ii) where the return is under section 8 and the taxpayer carries on a trade, profession or business in partnership, a reference to any partnership return with respect to the partnership for the relevant year of assessment or either of those periods; and

(*b*) any reference in paragraphs (*b*) to (*d*) to the taxpayer includes a reference to a person acting on his behalf.

(8) An objection to the making of an assessment under this section on the ground that neither of the two conditions mentioned above is fulfilled shall not be made otherwise than on an appeal against the assessment.

(9) Any reference in this section to the relevant year of assessment is a reference to—

(*a*) in the case of the situation mentioned in paragraph (*a*) or (*b*) of subsection (1) above, the year of assessment mentioned in that subsection; and

(*b*) in the case of the situation mentioned in paragraph (*c*) of that subsection, the year of assessment in respect of which the claim was made."

Disclosure Application

15. At the outset of the hearing the Tribunal considered an application by the Appellant for further disclosure of documents – broadly, details from the tax returns of the other 84 participants in the scheme, notes of a meeting between HMRC and Baker Tilley (successor firm to Mr Smith's accountants Kidsons), and details of responses from other Inspectors to the Newsboard Message. We refused that application and communicated that decision, with reasons, to the parties at the hearing. We record that Mr Conolly for HMRC, on instructions, confirmed to the Tribunal that HMRC had disclosed everything they had concerning HMRC's internal thinking on the SHIPS scheme up to 31 January 2003; also they had already made additional disclosure of all internal materials post- 31 January 2003.

16. The disclosed documents were included in the hearing bundle. We summarise below those which we consider pertinent to the current case.

(1) From around 2001 HMRC were aware of a tax avoidance scheme using second hand insurance policies (SHIPS) being promoted by the tax advisers McKie & Co. That was the scheme described in the Newsboard Message of July 2002. On 20 January 2003 Mr Lucas of SCO filed an internal formal "registration submission" (seven pages in length) on the scheme; it specifically considers the cases of Mr Drummond and other taxpayers, and included the following:

> "I recommend that the enquiry be opened under Code of Practice 8. This is a marketed avoidance scheme and there is no evidence of fraud at this stage. As mentioned above our potential arguments at this stage appear to be "all or nothing" arguments. As a result there has to be a degree of speculation involved with the enquiry. However this is a marketed scheme involving the creation of capital losses which are not reflected by the economic losses involved. … The s 9A enquiries will need to be opened by 31 January 2003. Once the facts are established the further advice of Capital & Savings will be sought."

(2) On 21 May 2003 there was a telephone discussion between Mr Cass of Capital & Savings Department (ie the head office technical expert) and Mr Gowler of SCO concerning "taking these [SHIPS schemes] forward despite the closure of the loophole in April's Budget." Mr Gowler's telephone note records:

> "DC stressed that [his department] would be reluctant to run with purely technical issues even though the *Strand Futures* case left the door open on s 37. … This was possibly not going to be a case that could be settled without being tested. … [DC] would not per se need to see the papers until we had firm evidence to support contentions that the scheme did not work and matters could not be concluded via negotiations."

(3) In November 2003 there was correspondence between Mr Gowler and Mr Watton (a colleague of Mr Cass) concerning the various technical arguments that might be available to challenge the McKie scheme, and reflecting a difference of views between them.

(4) By December 2003 HMRC had identified that a variant of the McKie scheme was being promoted by Kidsons (Mr Smith's accountants) and Baker Tilly. On 15 January 2004 Mr Gowler filed an internal formal registration submission (over five pages in length) on the scheme which included the following:

> "This case is a spin-off from the McKie … scheme [registration number] where technical arguments are being formulated with the assistance from Head Office Specialists. … SHIPs arrangements were heavily sold by Kidsons … Exactly how the scheme works is highlighted in David Cass' Newsboard Memo … Currently there are four main areas of interest on the McKie case although it is too early to say yet whether all these will apply to Baker Tilly/ Kidsons as facts

> have not been fully established. These issues which are currently being considered by Head Office Specialists are: (a) section 37 CGTA 1992 … (b) beneficial ownership … (c) section 548 ICTA 1988 … (d) stamp duty … [(e)] self-assessment … This will be Code 8 [ie Code of Practice 8 investigations] … I recommend that this is registered under Code 8 as a Scheme Registration … DD approval will be required however this case was discussed with [senior HMRC officials] … Around 30 Section 9A Notices have been drafted by the clerical section and will be issued once Scheme Registration is agreed. Pending Head Office advice I would imagine the first step will be to agree with Baker Tilly which particular cases are subject to ongoing enquiries and establishing the different ways in which SHIPS operate."

Respondents' Case

17. Mr Conolly for HMRC submitted as follows.

18. HMRC had made a "discovery" under s 29(1)(a) that "chargeable gains which ought to have been assessed to capital gains tax have not been assessed". The discovery hurdle was an exceptionally low one; it covered a mere change of mind as to either facts or law. This had recently been examined and confirmed by the Tribunal in *Charlton & Others v HMRC* [2011] SFTD 1160 where (at [74]) the Tribunal summarised the position:

> "A discovery assessment can be made merely where the original inspector changes his mind, or a new inspector takes a different view."

19. Similarly in *Blumenthal v HMRC* [2012] SFTD 1264 the Tribunal had stated:

> "[162] We suggest, unless and until a higher court takes a different view, this point is no longer open as regards this tribunal. In our view, HMRC can raise a discovery assessment under s 29(1) TMA, subject to the conditions referred to below, if it newly discovers—which includes a change of mind—any of the circumstances set out in sub-s (1)(a)–(b) apply ie in summary, that insufficient tax has been assessed or excessive relief has been given."

20. Section 29(3) restricted HMRC's ability to assess the loss of tax to the two situations described in subsections (4) or (5). Section 29(5) was relevant in the current case. The date described in subsection (5)(a) was, in the current case, 31 January 2003. The test was that, at that date, "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 situation mentioned in subsection (1) above."

21. The officer referred to in subsection (5) was not a real or actual officer but instead a notional officer. The Tribunal must consider what the notional officer could have been reasonably expected to be aware of on the basis of the information listed in subsection (6) – and no other documents. The Tribunal was not permitted to consider what the notional officer could have been expected to do (on the basis of that information) or indeed of what he could have been expected to be aware of after having done that thing which would have been reasonable for him to do.

22. In *HMRC v Household Estate Agents Ltd* [2008] STC 2045 Henderson J summarised the position of Auld LJ in *Langham v Veltema* [2004] STC 544 as follows:

> "[31] … Auld LJ (see [2004] STC 544 at [30], 76 TC 259 at [30]) identified the issues as being: (a) whether awareness or inference of actual insufficiency (of tax) is required to negative the condition, or whether awareness that it was questionable would suffice; (b) whether account should be taken of enquiries the inspector could reasonably have been expected to undertake, and the likely result of such enquiries; and (c) whether the relevant information before the inspector is simply that emanating from the taxpayer, and any inference that could reasonably be expected to be drawn from it, or whether it may also include other information before the inspector, such as a form P11D.
>
> [32] Auld LJ went on to hold that a restrictive or negative answer should be given to each of the above questions. Thus: (a) he held (see paras [34] and [35]) that the subject matter of the objective awareness with which s 29(5) is concerned is 'actual insufficiency', and the words 'on the basis of' (with reference to the specified information) do not denote 'an objective awareness of something less than insufficiency'; (b) accordingly, account should not be taken of what enquiries the Inspector could reasonably have been expected to undertake from the information supplied to him under s 29(6) and of what he could have reasonably learned from such enquiries (see para [35]); and (c) the inspector is to be shut out from making a discovery assessment (see [2004] STC 544 at [36]):
>
> > *'[36] … only when the taxpayer or his representatives, in making an honest and accurate return or in responding to a s 9A enquiry, have clearly alerted him to the insufficiency of the assessment, not where the Inspector may have some other information, not normally part of his checks, that may put the sufficiency of the assessment in question …'*
>
> So, for example, even if the form P11D had added anything material to the information provided by Mr Veltema in his return and the accompanying documents, it would have been irrelevant to the question of awareness of actual insufficiency posed by s 29(5) (see para [37]). Auld LJ described the passage which I have quoted in this paragraph as 'the key to the scheme', and derived support for it from the fact that the only categories of information expressly identified in s 29(6) emanate from the taxpayer."

23. Thus the Tribunal must have no regard to possible outcomes of lines of enquiry which the notional officer may or may not follow on the basis of the information detailed at subsection (6) – even if it would be reasonable for the officer to take those steps, or unreasonable for him not to take those steps.

24. Importantly, there was no obligation on HMRC to open an enquiry into a return where, say, they had reasonable grounds for suspicion that it understated the tax due – see Auld LJ in *Langham v Veltema* at [32]. Further, "the Inspector is not to have

attributed to him the further information that he would actually have obtained if he had opened an enquiry and asked for details …, unless and until such information is produced to him." – per Henderson J in *Household Estate Agents* (at [40]).

25. The defence for the taxpayer in the face of all this was provided by adequate disclosure by means of the documents listed in s 29(6). In the Scottish case of *R (oao Patullo) v HMRC* [2010] STC 107 the issue arose in the context of a judicial review application, with the taxpayer arguing that his white space disclosure precluded the prospect of a s 29 assessment being issued. The Court of Session stated (at [104]):

> "On a proper understanding a discovery assessment can only be foreclosed if the taxpayer has clearly alerted in his return the officer to the insufficiency of tax which the officer has asserted he has newly discovered, thus rendering it not a new discovery but rather something on the information provided by the taxpayer that the officer should have been aware of during the enquiry window. In my judgment on a proper construction the section clearly places the emphasis on the adequacy of the disclosure by the taxpayer. That fits in with the underlying purpose of the scheme. Thus the taxpayer is given the right of early finality. However, there is a corresponding duty on the taxpayer to clearly alert the officer to the insufficiency. If he does not the officer can newly discover an insufficiency. Accordingly I broadly accept counsel for the respondents' argument that in terms of the section it is for the taxpayer (once a newly discovered insufficiency is asserted) to prove that he has clearly alerted the officer to the insufficiency."

26. Turning to the adequacy of the white space disclosure the Court of Session stated:

> "[107] … The critical question in the case before me then becomes: should the information contained in the white space in the taxpayer's return have clearly alerted an officer having regard to the general knowledge and skill that might reasonably be attributed to him, of an insufficiency of tax? If it should have there could be no reasonable or sensible possibility of an assessment in terms of s 29; ...
>
> [108] Mr Johnston's [counsel for taxpayer's] position in summary was that the white space set forth each step that had been taken in order to give rise to the capital loss. In addition within the white space was set forth the specific section upon which reliance was placed for the said capital loss. Thus, as I understood it, his position was that the full factual and legal basis for the capital loss was set forth in the white space. It was his position that nothing new had arisen, ie that no discovery had been made which could found a discovery assessment. Thus it was his position that there was no sensible or reasonable possibility of an assessment in terms of s 29 ...
>
> [109] I am not satisfied that the information contained in the white space should have clearly alerted an inspector with the knowledge and skill as I have defined it to an insufficiency in tax."

27. In that case an HMRC technical specialist (Dr Brannigan) had been involved, but his specialist knowledge was not to be imparted to the notional officer relevant for s 29:

> "[110] It is clear looking to Dr Branigan's affidavit as a whole that he, as a result of his examination of the taxpayer's return, has reasons to believe that Mr Pattullo was a participant in a CRC Mark II Scheme which is a tax avoidance scheme … The avoidance scheme involves an interpretation of the relevant tax legislation …
>
> [111] Dr Branigan's position on a fair reading of his affidavit as a whole is: that (1) he was only able to reach this belief as a result of his specialist knowledge arising from his being the head of the team investigating the CRC Mark II scheme; (2) he is not at this stage able to say that he is aware of an actual insufficiency as he cannot say definitely that the petitioner was a participant. Further, if he was a participant, in the absence of the details of the scheme he is unable to say that he is aware of an actual insufficiency. Thus he is unable at this stage to proceed to a s 29 assessment and requires to proceed to a s 20 notice in order to discover documentation. The situation is accordingly very much on all fours with that in *R (on the application of Johnston) v Branigan (Inspector of Taxes)* where a s 20 assessment was held to be competent.
>
> [112] Given the position of Dr Branigan therefore the question for the court becomes: is there a clear alerting of an officer within the white space—that officer being one of ordinary knowledge and skill—of the participation by Mr Pattullo in such a scheme of tax avoidance and of an insufficiency in tax arising therefrom?
>
> [113] The answer to the above question is that I have not been satisfied by Mr Johnston's submissions that there was such a clear alerting within the white space."

28. The Court of Session enumerated some of the information which could have been contained in the white space and would have alerted the officer to an insufficiency:

> "[114] As is pointed out in his affidavit by Dr Branigan the white space does not contain the following:
>
> (1) A statement that Mr Pattullo was a participant in the CRC Mark II tax avoidance scheme. Dr Branigan (at para 26) makes clear that had there been such a statement this would have guaranteed that an enquiry would have been opened and that Mr Pattullo's tax advisers would have been aware of this.
>
> (2) A statement that the petitioner and his advisers had adopted a different view of the law from that published as HMRC's namely: they had taken a view in respect of the tax treatment of capital redemption contracts which is the opposite of that taken by HMRC Capital Gains Tax Manual at CG69004 dated 2 September 2003 (production 7/3) is not contained within the white space. The petitioner's tax return was not filed until 31 January 2005. The necessity to make such a declaration in order to comply with the

duty to clearly alert has been held to exist in *Revenue and Customs Comrs v Household Estate Agents Ltd* [2008] STC 2045, para 7(10) of the case stated, 78 TC 705, para 7(10) of the case stated where it was held as follows:

> *'7. … (10) taxpayers who adopt a different view of the law from that published as HMRC's can protect against a discovery assessment after the enquiry period. The returns and accounts would have to indicate that a different view had been adopted by entering comments to the effect that they did not follow HMRC's guidance on the issue or that no adjustment had been made to take account of it …'*

(3) There is no explanation as to how Mr Pattullo contends that s 37 operates in order to produce the capital loss.

(4) The details other than the basics of the transactions which have been entered into are not contained within the white space.

(5) There is no indication of any doubt in the disclosure that the petitioner is entitled to the loss. I accept Mr Johnston's position that the taxpayer does not require in order to clearly alert to say there is an insufficiency as of course that is not his position. However, in circumstances such as this a reference to doubt or as I have said to the fact that it is, a position contrary to HMRC's would be necessary to comply with the duty incumbent upon him.

In the absence of information of the type as above described an inspector of the skill and knowledge as I have earlier defined it could not in my judgment have been aware of actual insufficiency. In so finding I have had regard, as I believe I am entitled to, that on any sensible reading of Dr Branigan's affidavit, he is a person who is a specialist in the area of tax investigation and has particular and considerable experience regarding this particular type of tax avoidance scheme and he is as yet, as he makes clear within his affidavit, unable to say that the petitioner is definitely a participant in said scheme and, even if he is, that there is an actual insufficiency. Rather the position which he presently takes is that he still requires further information to decide whether there is such an insufficiency and accordingly to decide whether to raise a s 29 discovery assessment. …

[115] I do not believe for the foregoing reasons that Mr Johnston's position that the full factual and legal position is set forth in the white space is correct. The full factual position would have included a statement that the petitioner was part of such a scheme and a full statement of the legal position would have included a statement of doubt or a statement that a contrary position to the HMRC was being insisted upon together with a clearer picture of the operation of the scheme. I believe it is a fair conclusion to hold that the disclosure in the white space is a carefully crafted disclosure seeking to pass through the initial checks carried out by HMRC but in no way meeting the test of clearly alerting to an actual insufficiency."

29. In the current case:

(1) The scheme involved the interaction of complex legislation: ch II part XIII TA 1988 (life policies etc), s 210 TCGA 1992 (also life policies etc) and ss 37-39 TCGA (calculation of gains and expenditure). Section numbers had been quoted in the white space but no detailed technical explanation was given.

(2) No disclosure was made other than to the basics of the scheme – although it was accepted that the factual details provided in Mr Smith's return were significantly greater than were given in the case of *Patullo* and somewhat greater than in *Charlton*. HMRC did not suggest that the disclosure was "a carefully crafted disclosure seeking to pass through the initial checks" as in *Patullo*, but nevertheless it did not alert to an actual insufficiency.

(3) No indication was given that other tenable views were possible with respect to the scheme – although HMRC had not published any view on the efficacy of the scheme (because none had been taken), Mr Smith's accountants (Kidsons) had in their engagement letter in February 2001 stated "it cannot be guaranteed that Inland Revenue will accept the technical analysis and consequences of the transactions as set out to you."

(4) No indication was given that this was a tax avoidance scheme – although, to be fair to Mr Smith, that proposition had been doubted in *Blumenthal*.

(5) The scheme implementation documents were not supplied to HMRC.

(6) The notional officer would not have been aware of an insufficiency of tax even if the above requirements had been met owing to the complexity of the law in question.

(7) If the notional officer was under an obligation to seek guidance from internal HMRC specialists (which is denied), he would not before 31 January 2003, on the basis of the documents falling under s 29(6), have been "aware" of a tax loss, because (i) he would have had to request further documents as per the Cass Memo, and (ii) the specialists would not have informed him that there was a tax loss.

30. In *Charlton* a s29 assessment had been held to be invalid, on the facts of that case. HMRC had appealed that decision to the Upper Tribunal. The scheme used there was similar to the one employed by Mr Smith. The taxpayers had argued that their respective white space disclosures were adequate to alert HMRC to an insufficiency. By the time the taxpayers submitted their returns the Special Commissioners had already decided in *Drummond* that the scheme failed; thus HMRC had accepted that by that time HMRC technical specialists had formed a view as to the efficacy of the scheme. However, HMRC did not accept that the s 29 notional officer ought to be deemed to know that HMRC specialists had rejected the efficacy of the scheme. This point was formulated by the Tribunal as follows (at [100(d)]):

> "Fourthly, and of fundamental importance in this case, we ask how the notional officer, aware of, and only aware of, the information clearly attributed to him by sub-s 29(6), should be taken to consider the rights and wrongs of the self-assessment. Do we treat the officer as having to consider this question, in his 'dark room' without any reference to the

law, books, manuals and other guidance? Should we, in the alternative, treat the officer as proceeding in the way that we would have expected, and indeed in the way that HMRC themselves would have expected? That approach, on the present facts, would clearly extend to considering the law and to seeking specialist guidance in the way rendered obvious by the disclosure of the SRN. Granted that deeming the officer to sit and worry in his dark room without guidance is indeed the last manner in which we would expect the officer to proceed, is this unrealistic state of affairs one that we are compelled to adopt by statute or by any authority?"

31. The Tribunal took the view (at [119]):

> " - it was absolutely obvious from the information given in the white spaces of the returns, that the three appellants had participated in artificial tax avoidance schemes to generate capital losses; and
>
> - the disclosure of the SRN for the scheme, and the fact that the scheme had been implemented in the then current tax year, not only reinforced the point that the transactions were effected as part of a marketed tax avoidance scheme, but they also indicated that full disclosure would have been made to HMRC specialists of the workings of the scheme. From this information, it would have been obvious to any officer that those officers receiving the DOTAS disclosures in the [scheme registration document] would have considered the scheme with those in HMRC responsible for the specialist areas in question, and a view would already have been reached as to whether (i) the scheme might be challenged successfully under existing law; or (ii) whether a change in legislation was required, or (iii) whether the planning was considered reasonably acceptable such that neither (i) nor (ii) was appropriate."

32. Further:

> "[120] We have already suggested, in para [115] above, that where the notional officer, or even the distinctly above average officer, might well not have been expected to perceive doubtful matters of tax law in relation to the type of situation canvassed in that paragraph, it would not be appropriate to expect the officer to question the return unless doubt was expressly drawn to the officer's attention in the return. Absent such a 'flag' in the return, the officer could also not be assumed to have sought guidance from others into a matter that anyone could have missed. The fact that remote specialists within HMRC might have readily appreciated that the legal basis, on which the self-assessments had been submitted, were challengeable would be completely irrelevant. Thus in that situation, sub-s 29(5) protection might only be secured if the points were aired or flagged in some way by the return.
>
> [121] Where, however, as in this case, no officer could conceivably have missed the points made by the bullet points in para [119] above, it is inevitably the case that the officer would either have considered the law himself or, more appropriately still in the light of seeing the SRN, he would have sought guidance from specialist colleagues, who he would have known would have considered the scheme in depth. And

> he would consider their views before deciding whether or not assessments were justified."

33. HMRC considered that *Charlton* was wrongly decided on this point, and had appealed to the Upper Tribunal accordingly. *Langham v Veltema* is clear authority that it is what "an officer" can be *aware* of that is relevant under s 29(5), not what that officer would or should have *done* on the basis of his knowledge. That view had received support in *Sanderson v HMRC* [2012] SFTD 1033 (at [64]). But even if *Charlton* was correctly decided on that point, that would not assist Mr Smith. HMRC's specialists had not come to the view, by 31 January 2003, that the scheme did not work. The Cass Memo demonstrates that the specialists were tentatively exploring various lines of enquiry with regard to whether the scheme worked. No clear view had been taken on the success or failure of the scheme as a matter of legal analysis. It indicated that no view should be taken without sight of all the relevant documentation used by the particular taxpayer, and Mr Smith had not provided that documentation. Even if the documentation had been provided, HMRC specialists had not formed a clear view as at 31 January 2003 that the scheme did not work; they were still in May 2005 in an undecided state of mind over the scheme, as evidenced by a memo between specialists dated 18 May 2005.

34. What may have been an adequate disclosure of the relevant scheme for the tax year 2007-08 in *Charlton* is not necessarily adequate in relation to the scheme employed by Mr Smith for the year 2000-01. HMRC's understanding of the schemes and how to challenge them had clearly moved on significantly between January 2003 and January 2009.

35. In *HMRC v Lansdowne Partners Limited partnership* [2012] STC 544 the Court of Appeal stated:

> "[56] In the end, this part of the appeal boils down to a very short point. The question, to adopt the formulation used by Auld LJ, is whether the hypothetical inspector having before him [stated documents] would have been aware of 'an actual insufficiency' in the declared profit. … I do not suggest that the hypothetical inspector is required to resolve points of law. Nor need he forecast and discount what the response of the taxpayer may be. It is enough that the information made available to him justifies the amendment to the tax return he then seeks to make. Any disputes of fact or law can then be resolved by the usual processes."

36. However, the point of law in issue in *Lansdowne* was a relatively simple one (see [69]) and Moses LJ clearly had in mind that the position would be different where a complex legal issue arose (*ibid*). The situation in Mr Smith's case was that he used a scheme dependent on a complex legal analysis. The point had been acknowledged by the Tribunal in *Blumenthal* at [172 – 173].

37. The decision to raise an assessment was not one to be taken lightly; HMRC would rightly be criticised if they assessed a taxpayer (and thus created an actionable debt) just because they suspected he had participated in a tax avoidance scheme. HMRC had to be sure of their technical grounds for challenging a scheme – after all,

some schemes did, apparently, work successfully (see *Mayes v HMRC* [2011] STC 1269).

38. The position adopted by HMRC in Mr Smith's case was reasonable.

(1) Auld LJ in *Langham v Veltema* (at [36]) made clear that the making of an honest and accurate return was not enough to exclude s 29; that return must clearly alert the notional officer to the tax loss:

> "It seems to me that the key to the scheme is that the Inspector is to be shut out from making a discovery assessment under the section only when the taxpayer or his representatives, in making an honest and accurate return or in responding to a s 9A enquiry, have clearly alerted him to the insufficiency of the assessment, not where the Inspector may have some other information, not normally part of his checks, that may put the sufficiency of the assessment in question."

(2) Culpability was not in issue – that was addressed by s 29(4) which is not in point here.

(3) There are long stop dates for assessments in any event: ss 34 & 36 TMA 1970. Those provide the taxpayer with a further layer of finality.

39. Mr Conolly also cited the cases of *Corbally-Stourton v HMRC* [2008] SRC (SCD) 907 and *Hankinson v HMRC* [2012] STC 485.

Appellant's Case

40. Mr Bell for Mr Smith submitted as follows.

41. It was accepted that the case of *Drummond* determined that the tax planning scheme adopted by Mr Smith had been ineffective.

42. If HMRC had acted with due expedition and raised the assessment before the end of the enquiry window then the assessment would be valid.

43. In *Charlton* the two taxpayers had employed in 2006-07 a tax planning scheme similar (though not identical) to that used by Mr Smith in 2000-01. It too was ineffective, per *Drummond*. 38 other taxpayers had used the scheme and had s 9A enquiries opened in time. Due to administrative errors HMRC failed to open enquiries into the returns of the two appellants and, when they realised their error, issued s 29 discovery assessments.

44. The Tribunal found (at [105]) that, in order to satisfy the condition in section 29(5):

> "HMRC must show that the notional officer, relying on all of, but no more than, the subsection (6) information *would not have arrived at the belief,* at the end of the enquiry window, that there had been an under-assessment, and that in order to rectify matters a *new assessment was justified,* and that assessment had a reasonable chance of being sustained."

45. The Tribunal found that, confronted with the information listed in section 29(6), an "average" officer would have been alerted to the fact the Appellants had entered into a marketed tax avoidance structure and the inclusion of the official scheme reference number would have made it obvious that a formal disclosure would have been made to HMRC specialists and that these specialists would most likely have already taken a view as to whether the arrangements might be successfully challenged. Therefore, had the officer made such enquiries he would have been alerted to the view within HMRC that the arrangements did not result in available losses, as supported by the decision in *Drummond*. Accordingly, an averagely competent HMRC officer would have discovered the under-assessment.

46. However, HMRC submitted that the chain of enquiry which the section 29(6) information might prompt was simply not relevant. The effect of section 29(6) was that the notional officer referred to in section 29(5) was deemed to have considered only the information listed in section 29(6) and the legislation did not permit any further enquiries which that information may have prompted to be taken into account. Rather, the legislation envisages that the notional officer will review the information listed in subsection (6) and then decide whether a new assessment is justified without recourse to further research or enquiries. That this was (hopefully) not how an officer would in reality behave did not matter.

47. As the Tribunal put the question (at [100(d)]):

> "granted that deeming the officer to sit and worry in his dark room without guidance is the last manner in which we would expect the officer to proceed, is this unrealistic state of affairs one that we are compelled to adopt by statute or by any authority?"

48. The Tribunal decided that it was not, though seemed to reach the decision based on a broad view of the purpose of the section 29(5) condition rather than an analysis of the wording of the legislation. It concluded (at [122]):

> "if it is glaringly obvious either that the relevant officer should consider the law, and possibly refer to published material or, where an SRN number is disclosed, simply send an e-mail or make a phone call to colleagues and ask for guidance, this is precisely how we should treat the notional officer as proceeding".

49. An important distinction between *Charlton* and the current case is that in *Charlton* the actual officer did not make enquiries which the Tribunal deemed should have been made. In the current case, however, such enquiries were indeed made by Mr Hiron. There was not a late discovery by an officer. 84 taxpayers used the same scheme as Mr Smith, and 51 had enquiries opened within the normal window. Clearly HMRC had already taken a view on the validity of the scheme and during the normal enquiry window this “material” would not (per *Charlton*) satisfy the pre-condition for a late assessment in that “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 situation mentioned in subsection (1)”.

50. The actual state of awareness of the HMRC officers is clear from the evidence. The Newsboard Message stated that the scheme was to be challenged and advised that enquiries should be opened. The officer (actual or notional) considering Mr Smith's return was clearly aware of Mr Cass's involvement. HMRC's consideration was resolved into hard policy in view of the 51 enquiries that were opened in time.

51. It was clear from the Cass Memo that HMRC had decided to raise assessments challenging the tax returns of the scheme participants. Also that HMRC were aware that Mr Smith had used the scheme. Further that Mr Hiron should open an enquiry into Mr Smith's return – and he would have done exactly that except for his extended sick leave. The sole reason for the enquiry not being opened was Mr Hiron's absence and HMRC's failure to re-assign the file to another officer.

52. Mr Hiron was, before 31 January 2003, fully aware of the situation and was dealing with it (with Mr Cass) and his awareness came from the information contained in Mr Smith's tax return. It cannot be correct that HMRC's incompetence in failing to open an enquiry during the permitted window (which they managed to do for 51 other taxpayers) can be overcome by substituting a mythical notional officer (who would not be aware of the situation from the information provided on the return) for Mr Hiron and his actual state of knowledge.

53. *Langham v Veltema* concerned a completely different situation where the court was concerned with whether the officer failed to realise the true position based only on the information in the tax return. The court found that he was not required to have any information over and above that supplied to him by the taxpayer; also, that the information so provided was inadequate to make him aware of the insufficiency. In the current case, by contrast, the officer was aware of the situation and was dealing with it. HMRC invited the Tribunal to make a fictional substitution of a notional officer (without the actual knowledge clearly held by Mr Hiron) solely in order to allow an assessment out of time. The Tribunal should not ignore the actual state of knowledge and replace it with a hypothetical state of ignorance.

54. *Corbally-Stourton* should also be distinguished. There the officer had never seen the return but accepted that had he seen it then he would have been suspicious and would have pursued an investigation. In the current case the officer *had* seen the return and *had* been suspicious – indeed, would have opened an enquiry but for his extended sick leave. Had a colleague been appointed to check his post (and so seen the Cass Memo) then again an enquiry would have been opened in time.

55. HMRC had highlighted that Mr Smith's return did not openly state that a tax avoidance scheme had been used (although that was doubted to be important in *Blumenthal*), nor give a detailed technical analysis of how the scheme was intended to work. That was accepted but was irrelevant – the information contained in the return was clearly sufficient to alert Mr Hiron to the use of a scheme; he spotted it was the type of scheme described in the Newsboard Message and that was why he contacted Mr Cass. The absence of certain information from the return was obviously not the reason why no assessment was raised before the deadline.

56. HMRC's best argument is that it did not matter that Mr Hiron was alerted to the insufficiency by Mr Smith's return; rather he should be substituted by a fictional, notional, less competent officer who might not have been so alerted – all to justify raising an assessment out of time.

57. HMRC's contention that their specialists had not formed a clear view by 31 January 2003 that the scheme did not work, was wrong – 51 out of 84 scheme users had enquiries opened within the window. Mr Cass' November letter states, "We have now been able to finalise our thoughts ..." – more than two months before the window closed HMRC experts had formed a perfectly clear view that the scheme did not work. Their only doubt was how to challenge it, not whether it was effective.

58. All the authorities cited by HMRC are concerned with situations where the officers did not understand or appreciate the full position based on the information provided by the taxpayer. None of them deal with the position in the current case: the officer did understand the full position, he had liaised with Mr Cass and had been told why the scheme did not work, and he was told to open an enquiry within the window.

59. HMRC's evidence was that their understanding of the scheme and how to challenge it moved forward significantly between 31 January 2003 and 31 January 2009 (the end of the window for the taxpayers in *Charlton*). But that was irrelevant – their understanding in November 2002 was clearly sufficient to warrant them challenging the scheme for 51 taxpayers, and they had enough information from Mr Smith's return to identify him as the 52nd, had not Mr Hiron's absence (without a substitute) intervened. Mr Hiron's comment of "Too late!" referred to him being too late to issue an assessment, as well as too late to open an enquiry.

60. Even if a notional officer should be substituted, in the same position as Mr Hiron he would have reached the same conclusion and taken the same actions. The Tribunal should note the cautions voiced by the Tribunal in *Blumenthal* at [181 – 182].

61. The outcome sought by HMRC could produce the unwelcome situation that HMRC were better off under s 29 deliberately refraining from conscientiously opening and pursuing an enquiry, asking awkward questions and obtaining information. That could not be correct. Section 29 gave powers to HMRC in the case of newly discovered facts or law – it was not intended to assist HMRC in retrospectively dealing with their own incompetence.

Consideration and Conclusions

62. After the conclusion of the hearing the Upper Tribunal issued its decision on HMRC's onward appeal from the First-tier Tribunal in *Charlton* – see [2013] STC 866. We decided it was not necessary to invite further representations from the parties on that decision, as it does not raise any issues that would cause us to change the conclusions we have reached in the current case. We have, however, referred to the relevant passages in the Upper Tribunal's decision below where appropriate.

63. Although we did not take formal oral evidence from Mr Smith, he attended the hearing and we listened to informal oral representations which he made to us. We understand his point of view. He considers that he acted on the advice of his accountants to participate in what he says he understood was, back in 2000, some uncontroversial tax planning. His accountants filed his tax return and the deadline for enquiry passed in January 2003 without event. The first he learned of any problem was the HMRC letter in March 2006 and the disputed assessment was not raised until November 2006. During the document discovery exercise it became apparent that HMRC had spotted the issue back in 2002 and the only reason why an enquiry was not opened was the extended sick leave of the local inspector, with no one apparently watching his mail during that absence. The failure to open an enquiry in time was HMRC's mistake. Nothing new had come to light and there had been no concealment. The Inspector hit the nail on the head, says Mr Smith, when he recorded that HMRC were simply "Too late!".

64. However, unfortunately for Mr Smith, the courts have analysed the effect of s 29 in a different manner. We consider the correct approach for us is to address in turn three issues:

(1) Was there a discovery that chargeable gains which ought to have been assessed to CGT had not been assessed - within s 29(1)?

(2) What information was made available to the officer before 31 January 2003 – within s 29(6) & (7)?

(3) Could the officer, at 31 January 2003, have been reasonably expected to be aware of the unassessed gains, on the basis of the information made available to the officer before that time – within s 29(5)?

Was there a discovery that chargeable gains which ought to have been assessed to CGT had not been assessed - within s 29(1)?

65. Although the courts have on occasions attempted to give an everyday meaning to "discovery" – see, for example, ***R v The Kensington Income Tax Comrs (ex p Aramayo)*** (1913) 6 TC 279 – the current state of the caselaw means that "discovery" is a term of art, with a particular meaning in the context of s 29. A point alluded to in several of the authorities cited to us is that it seems an odd use of language that one may, apparently, discover something one already knows. However, we consider the matter is – at least so far as concerns authorities binding on this Tribunal – clear: there is a low hurdle to establish a discovery within s 29(1), although the knowledge (awareness) of HMRC is relevant to the later subsections of s 29. We agree with and adopt the statement by the Tribunal in *Blumenthal*:

> "[162] We suggest, unless and until a higher court takes a different view, this point is no longer open as regards this tribunal. In our view, HMRC can raise a discovery assessment under s 29(1) TMA, subject to the conditions referred to below, if it newly discovers—which includes a change of mind—any of the circumstances set out in sub-s (1)(a)–(b) apply ie in summary, that insufficient tax has been assessed or excessive relief has been given."

66. The Upper Tribunal in *Charlton* (where the events were declared on the 2006-07 tax returns) stated on this point:

> "[11] Various procedures within HMRC failed to result in enquiries being opened into the taxpayers' returns. It was only when Mr Cree, the officer in charge of co-ordinating all investigations into so-called SHIPs (second-hand insurance policies) schemes of the nature of this case, became aware in March 2009 of what had happened, and called for the papers, that consideration was given to the making of assessments under s 29. He did not make those assessments immediately; instead he waited until after the Court of Appeal's judgment in *Drummond* ([2009] STC 2206, 79 TC 793) and after it became clear that there would be no appeal to the Supreme Court.
>
> …
>
> [37] In our judgment, no new information, of fact or law, is required for there to be a discovery. All that is required is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment. That can be for any reason, including a change of view, change of opinion, or correction of an oversight. The requirement for newness does not relate to the reason for the conclusion reached by the officer, but to the conclusion itself. If an officer has concluded that a discovery assessment should be issued, but for some reason the assessment is not made within a reasonable period after that conclusion is reached, it might, depending on the circumstances, be the case that the conclusion would lose its essential newness by the time of the actual assessment. But that would not, in our view, include a case, such as this, where the delay was merely to accommodate the final determination of another appeal which was material to the liability question. Such a delay did not deprive Mr Cree's conclusions of their essential newness for s 29(1) purposes.
>
> …
>
> [44] … a discovery assessment can be made merely where the original officer of HMRC changes his mind or where a different officer takes a different view."

67. We conclude that HMRC did make a discovery within s 29(1) of a matter described therein.

What information was made available to the officer before 31 January 2003 – within s 29(6) & (7)?

68. In *Langham v Veltema* Auld LJ stated (at [36]):

> "… It seems to me that the key to the scheme is that the Inspector is to be shut out from making a discovery assessment under the section only when the taxpayer or his representatives, in making an honest and accurate return or in responding to a s 9A enquiry, have clearly alerted him to the insufficiency of the assessment, not where the Inspector may have some other information, not normally part of his checks, that may put the sufficiency of the assessment in question. If that other

> information when seen by the Inspector does cause him to question the assessment, he has the option of making a s 9A enquiry before the discovery provisions of s 29(5) come into play. That scheme is clearly supported by the express identification in s 29(6) only of categories of information emanating from the taxpayer. It does not help, it seems to me, to consider how else the draftsman might have dealt with the matter. It is true, as Mr Sherry [counsel for taxpayer] suggested, he might have expressed the relevant passage in s 29(5) as "on the basis only of information made available to him", and the passage in s 29(6) as "For the purposes of subsection (5) above, information is made available to an officer of the Board if, but only if," it fell within the specified categories. However, if he had intended that the categories of information specified in s 29(6) should not be an exhaustive list, he could have expressed its opening words in an inclusive form, for example, "For the purposes of subsection (5) above, information … made available to an officer of the Board … includes any of the following".'"

69. We also have the benefit of the summary of Henderson J in *Household Estate Agents* quoted at [22] above.

70. The list of information items in s 29(6) & (7) is exhaustive. In particular, information held by HMRC but not of a description within subsections (6) & (7) – for example, Mr Cass's file on the SHIPS scheme and variations thereof – is to be ignored.

71. We consider the relevant information in the current case was the contents of Mr Smith's 2000-01 tax return including the white space disclosures, as quoted at [3] above.

72. We would note that in *Charlton* in the Upper Tribunal there is considerable discussion on this point - because there was an important issue as to whether the contents of a separately filed document (a tax avoidance scheme disclosure) formed part of the relevant information – but no such complications arise in the current case.

Could the officer, at 31 January 2003, have been reasonably expected to be aware of the unassessed gains, on the basis of the information made available to the officer before that time – within s 29(5)?

73. Much of the Appellant's case is based on the fact that for 51 of the 84 users of the scheme HMRC did open s 9A enquiries by 31 January 2003, and HMRC were minded to do the same for Mr Smith but simply missed the deadline for administrative reasons (ie reasons unconnected with Mr Smith's position or HMRC's thinking on the scheme). However, we consider there is an important difference between

> (a) HMRC being aware of matters that, in their view, warrant the opening of a s 9A enquiry, and
>
> (b) "The officer" being "reasonably expected, on the basis of the information made available to him before [31 January 2003], to be aware

of the [s 29(1)] situation", as required by s 29(5) so as to provide a defence to the taxpayer (and as interpreted by the courts).

74. We make as findings of fact that by 31 January 2003:

(1) HMRC were aware of the SHIPS scheme, and variants of it – see the Newsboard Message.

(2) HMRC were minded to challenge the SHIPS scheme but were still considering a number of "possible counters", some of which were in the alternative – see the Cass Memo. Even after 31 January 2003 HMRC were unsure what technical arguments to advance against SHIPS – see the May 2003 telephone conference described at [16(2)] above. Even in January 2004 the scheme as used by Mr Smith was still being considered by SCO, whose view was, "Currently there are four main areas of interest on the McKie case although it is too early to say yet whether all these will apply to Baker Tilly/ Kidsons as facts have not been fully established." – see [16(4)] above. Even by January 2004 (ie a year after Mr Smith's enquiry window closed) HMRC had not moved beyond deciding to open enquiries on users of the Kidsons scheme, to establish "the different ways in which SHIPS operate" – *ibid*.

(3) HMRC had decided to open s 9A enquiries on the returns of users of the scheme – Mr Cass' communications respect the HMRC protocol that the decision to open an enquiry belongs to the responsible Inspector but we consider the intention was plain, and Mr Hiron took it as such (see his annotation to the covering letter to the Cass Memo).

(4) The only reason why a s 9A enquiry was not opened on Mr Smith's return was the absence of Mr Hiron on sick leave without any substitute taking over the file.

(5) Mr Hiron's annotation to the covering letter to the Cass Memo, "Too late!", referred to being too late to open a s 9A enquiry into the 2000-01 return; it was never contemplated that an assessment should be raised before 31 January 2003.

75. If the relevant test in s 29 was whether Mr Hiron was by 31 January 2003 aware of matters that warranted the opening of a s 9A enquiry then Mr Smith would have a strong case, as persuasively argued by Mr Bell. But that is not the correct test. The test is not even whether a notional officer should have been by 31 January 2003 aware of matters that warranted the opening of a s 9A enquiry. The test, as interpreted by the courts, is whether the notional officer could not have been reasonably expected, on the basis of the information made available to him before 31 January 2003, to be aware of the s 29(1) situation. That is a very different test. As stated by the Tribunal in *Blumenthal*:

> "[186] Mr Way [counsel for taxpayer] argued that because materially identical white space disclosures made by two other taxpayers prompted other officers to launch enquiries within the one-year 'window' this should be taken as an indication that the appellant's white space disclosure was sufficient for the condition in s 29(5) to prevent a discovery assessment. We disagree. *Veltema* is clear authority that it is

> not enough that the disclosure should have alerted an inspector to the need to make further enquiries. The disclosure must alert the hypothetical inspector to an objective awareness of an actual insufficiency."

76. We consider that view was endorsed by the Upper Tribunal in *Charlton*:

> "[92] We accept that the test is not whether the officer should have opened an enquiry. There is a clear distinction between cases where the information made available to the officer merely raises questions, which can only be resolved by the obtaining of further information, and those where the available information provides awareness of an insufficiency that is sufficient to justify the making of an assessment. *Langham v Veltema* is an example of the former case; *Lansdowne* an example of the latter. Where the enquiry window remains open, it will often be the case that an officer, faced with a taxpayer's return that could itself justify an assessment, will open an enquiry in the normal course. That may either resolve an issue in favour of the taxpayer, or provide confirmation of the need to make an amendment to the taxpayer's return. Once the enquiry window has closed, that option is no longer available, but the mere fact that an officer might have made such enquiries had it been open for him to do so, does not mean that he cannot reasonably be expected to have been aware, from the information he does have available, of the insufficiency so as to justify the making of an assessment. The test is one of awareness, and not one of certainty or even probability. It is, as Moses LJ said in *Lansdowne* (at [70]), a matter of perception and of understanding, not of conclusion."

77. We consider it settled law that "the officer" described in s 29(5) is a hypothetical or notional officer – see, for example, the Court of Appeal in *Lansdowne Partners*. The Appellant stressed – and HMRC expressed strong reservations about – certain statements by the Tribunal in *Charlton* concerning the position and characteristics of the notional officer. Those matters have been resolved by the subsequent appeal to the Upper Tribunal and we cover that below. However, even absent the Upper Tribunal's views, we note that other panels of the Tribunal have expressed doubt about whether (the First-tier Tribunal in) *Charlton* gave the best interpretation of the position - see, for example, *Blumenthal* at [181] – and we share those reservations. The position is now as explained by the Upper Tribunal in *Charlton*:

> "[53] We think it is plain from what Auld LJ said in *Langham v Veltema* that the question to be addressed is the awareness of an officer, and not on what an officer might do. We do not consider that it is the right approach to take as a starting point a hypothetical officer with limited knowledge and then to assume, however glaringly obvious it might be to do so on that hypothesis, that the officer would seek guidance from other 'real' officers within HMRC. That is not what s 29(5) requires the tribunal to consider. We do not accept that the strictures adopted in *Langham v Veltema* are confined to enquiries concerning facts. In our view, the language of awareness in s 29(5)

> precludes any assumption that a notional officer would consult more specialist colleagues. …
>
> …
>
> [65] Our conclusion on this point, therefore, is that s 29(5) does not require the hypothetical officer to be given the characteristics of an officer of general competence, knowledge or skill only. The officer must be assumed to have such level of knowledge and understanding that would reasonably be expected in an officer considering the particular information provided by the taxpayer. Whilst leaving open the exceptional case where the complexity of the law itself might lead to a conclusion that an officer could not reasonably be expected to be aware of an insufficiency, the test should not be constrained by reference to any perceived lack of specialist knowledge in any section of HMRC officers. What is reasonable for an officer to be aware of will depend on a range of factors affecting the adequacy of the information made available, including complexity. But reasonableness falls to be tested, not by reference to a living embodiment of the hypothetical officer, with assumed characteristics at a typical or average level, but by reference to the circumstances of the particular case.
>
> [66] This conclusion does not have the consequence that the hypothetical officer must be regarded as the embodiment of HMRC as a whole. *He cannot in this way be treated as possessing information relevant to his awareness that is held elsewhere within HMRC or is known to any particular officer, including the officer dealing with the case* [emphasis added]. That is clear from *Langham v Veltema*, and from the exhaustive nature of the information that can be considered to be made available to the hypothetical officer in accordance with s 29(6). Our conclusion relates only to the knowledge and skill to be attributed to the hypothetical officer in each case. …"

78. So we must consider the notional officer as at 31 January 2003 in possession of Mr Smith's 2000-01 return (including the white space disclosures). Could he have been reasonably expected to be aware of the insufficiency?

79. The return does not specifically draw the officer's attention to the fact that Mr Smith participated in a tax avoidance scheme during the year. That was held to be a relevant factor in the Scottish case of *Patullo* (at [115]). In our view, although it is relevant it is only one of several relevant factors (and we understand the Outer House to be saying as much at [114]) – we note that the Tribunal in *Blumenthal* took a different view (at [204 – 205]). (In *Charlton* the point did not arise – or more accurately, was a foregone conclusion – because the return included a registered tax avoidance scheme reference number.)

80. The white space entries describe the acquisition and redemption of the bond; they cross-refer between the income pages and the capital gain pages; they cite s 541 TA 1988 and ss 22 & 37 TCGA 1992; they show the (simple) calculation of nil income and a £532,695 capital loss on redemption; and they give a short description of how those results are obtained.

81. An important and relevant point arising from *Lansdowne Partners* concerns the degree of complexity of the legal position governing the matter under consideration. In that case the contentious item concerned the deductibility of payments to partners, a matter on which there was clear House of Lords authority (see [50]). Moses LJ stated:

> "[69] … The legal points were not complex or difficult. As the Chancellor points out (at [56]), awareness of an insufficiency does not require resolution of any potential dispute. After all, once an amendment is made, it may turn out after complex debate in a succession of appeals as to the facts or law, that the profits stated were not insufficient. I have dwelt on this point because I wish to leave open the possibility that, even where the taxpayer has disclosed enough factual information, there may be circumstances in which an officer could not reasonably be expected to be aware of an insufficiency by reason of the complexity of the relevant law."

82. In our opinion the relevant law relating to the scheme adopted by Mr Smith was of a degree of complexity such as to make it unreasonable for the officer *to be aware of an insufficiency* on the basis of the information contained in Mr Smith's tax return. We do consider that the information was sufficient to warrant the hypothetical officer opening a s 9A enquiry – but that is not the relevant test. We note that a similar conclusion was reached by the Tribunal in *Blumenthal* (at [206]) on the facts in that case.

83. In *Charlton* both the First-tier and Upper Tribunal rejected the validity of the s 29 assessment. There were two important factual distinctions from the current case.

(1) First, in *Charlton* the taxpayers' returns included the scheme reference number that had been allocated by HMRC when the tax avoidance scheme had been registered by the scheme promoters. The relevant legislation post-dates the 2000-01 tax year in point in the current case.

(2) Secondly, in *Charlton* before the taxpayers submitted their returns the Special Commissioners had already decided in *Drummond* that the scheme failed. Further, the High Court had affirmed the decision of the Special Commissioner on 23 July 2008, which was before the expiry of the relevant enquiry window on 31 January 2009. HMRC accepted that by 31 January 2009 HMRC technical specialists had formed a view as to the efficacy of the scheme. In the current case, obviously, *Drummond* was still several years away when the enquiry window closed in January 2003. From our findings at [74] above we conclude that at 31 January 2003 HMRC were ruminating on whether the McKie version of SHIPS really worked, and had not then yet addressed their minds to the Kidsons variant of SHIPS as used by Mr Smith; that came almost a year later with Mr Gowler's registration application (see [16(4)] above) and even then no firm view had been reached above a need to establish how that variant worked. Accordingly, the hypothetical officer, even if he could or should have accessed the minds of HMRC's technical specialists, "could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the [insufficiency]."

84. We conclude that the second condition in s 29(3), as stated in s 29(5) and as interpreted by the courts, was satisfied in this case. Accordingly the discovery assessment was validly raised.

Decision

85. The appeal is DISMISSED.

86. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 27 June 2013