TC03800

Appeal number: TC/2014/01649

Corporation Tax – para 33 Sch 18 FA 98 – application for closure notice- discovery assessment made before enquiry opened – settled by agreement – effect of settlement on scope and possible conclusions of enquiry – **Olin v Scorer** ***considered- reasonableness of continuing enquiry***

FIRST-TIER TRIBUNAL
TAX CHAMBER

EASINGHALL LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE CHARLES HELLIER
MR TYM MARSH

Sitting in public in Southampton on 1 July 2014

Michael Feng of Feng & Co for the Appellant

Paul Shea for the Respondents

DECISION

1. Eastinghall Limited applies for a closure notice in respect of the enquiry into its 2011/12 tax return

The Factual Background

2. There was no dispute about the following facts.

3. HMRC received the company's tax return for 2011/12 on 21 March 2013. At that time an enquiry was open into its 2010/11 return. Gavin Laurie, the officer conducting that enquiry issued a closure notice in respect of 2010/11 on 18 October 2013. He concluded that the company had understated its profits for the period. He came to this conclusion because he had information that the company had not recorded all its purchases, and he inferred that it had also failed to record the corresponding sales. In that closure notice he amended the company's taxable profits and the computation of the corporation tax due.

4. At the same time Mr Laurie also concluded that it was likely that the company had understated its profits and its tax liability for 2011/12 in the same way. He did not have any direct evidence that this was the case but presumed that the company's practice had been continuous.

5. This time was within the 12 months following the delivery of the company's 2011/12 tax return. Mr Laurie could therefore have opened an enquiry into that return. But he did not choose that course of action: instead, and on the same date as he gave the 2010/11 closure notice, namely 18 October 2013, he made a "discovery assessment" under paragraph 43 schedule 18 FA 1998. In that assessment he assessed the company to further corporation tax of £8,544.20 for 2011/12.

6. The company appealed against both the amendment to its 2010/11 tax return and the discovery assessment for 2011/12, and sought a review of the matter under section 42 TMA 1970. This review was concluded on 7 February 2014 by Mr Musgrove. Mr Musgrove came to the conclusion that (1) there was evidence to show that purchases had been omitted from the business records and the likelihood was that those purchases had been omitted to cover corresponding omitted sales. He noted that Mr Laurie had made an omission in his calculations and decided that the extra tax payable for 2010/11 should be reduced somewhat, (2) that the company had acted deliberately in concealing profits and its behaviour merited a penalty and (3) that the 2011/12 assessment should be reduced to nil. He said

> "**Year ended 31/3/2012**
>
> I consider that there is insufficient evidence to support the amount assessed in this year.
>
> I consider that the decision for this year should be cancelled"

> …I have given consideration to the basis of presumption of continuity when arriving at my conclusion in respect of the year ended 31 March 2012".

And towards the end of this letter that Mr Musgrove said:

> "If I do not hear from you and you do not appeal to the tribunal within 30 days of this letter I will assume that you agree with my conclusion and the matter will be treated as settled by agreement under section 54 (1) Taxes Management Act 1970, I will then make arrangements for the tax due to be collected."

7. The company made a formal appeal to the tribunal against the conclusion of the review in respect of 2010/11 but took no further action in relation to the conclusion that the discovery assessment for 2011/12 would be reduced to nil.

8. A week after the date of Mr Musgrove's letter, on 15 February 2014 Mr Laurie wrote to the company saying that he was opening an enquiry in relation to its 2011/12 tax return. This letter was written within the 12 month period after the making its tax return for that year and so within that period permitted for the opening of an enquiry.

9. Two days later Mr Laurie wrote the company seeking certain information and documents in relation to 2011/12. He repeated the request by sending a formal information notice on 24 March 2014. On the same day Mr Feng wrote to the tribunal enclosing an application for a direction that enquiry into 2011/12 should be closed pursuant to paragraph 33 Schedule 18. The letters crossed in the post.

10. On receipt of the information notice Mr Feng wrote to Mr Laurie on 26 March 2014 saying:

> "The client wants a statutory review and the grounds are in the application to close enquiry to the tribunal. A copy of the application is enclosed for your attention."

11. There then followed correspondence between the parties in which Mr Laurie pressed his claim to the information and Mr Feng to the statutory review. This included a rather unproductive debate as to whether or not Mr Feng's letter of 26 March 2014 was an appeal, a statement by Mr Feng that following Mr Musgrove's letter the company had disposed of the records relevant to 2011/12 and an assertion by Mr Laurie that the accountants' working papers would serve his purpose even if the company no longer had the detailed records.

Mr Laurie's evidence

12. We heard oral evidence from Mr Laurie.

13. Mr Laurie told us that by serving third-party information notices in respect of 2011/12 he had obtained information from the company's suppliers of the sales they had made to the company. He proposed to compare these figures to those in the company's records (which he had sought in information notice) to determine whether any purchases had been omitted. If he discovered that they had been he would make an adjustment to the company's return for 2011/12 in the same manner as he had

made for 2010/11. He would be able to do this exercise from the accountant's working papers even if the company no longer had the relevant records. Mr Laurie said that he had already used the figures he had obtained from suppliers to make a rough comparison of the company's purchases with the figure which appeared in the 2011/12 accounts, and had made a rough estimate the profit he thought was underdeclared. The further information he had requested would enable him to reach a more accurate figure. He could not reasonably close the enquiry until he had conducted that exercise.

14. Mr Laurie accepted that the focus of his enquiry was presently on the under recording of the company's sales, purchases and profits.

The parties' arguments

15. Mr Feng says:

(1) that the letter from Mr Musgrove acknowledges that the appeal against the discovery assessment for 2011/12 was settled by agreement;

(2) that the effect of section 54 TMA is that the same consequences ensue as if the appeal had been determined by a tribunal which decided matters in the terms of the agreement;

(3) the effect of the predecessor provisions to section 50(10) and 54 TMA were discussed in *Cenlon Finance Co. Ltd, v Ellwood* [1961] Ch. 50; [1961] Ch. 634, where the Court of Appeal held that the effect of what is now section 50(10) was that where a particular point had been determined by a tribunal it could not be relitigated; and that the effect of what is now section 54 was that when a particular point had been agreed, both parties were bound and it was not open to HMRC in the guise of a discovery assessment to relitigate the point;

(4) thus no amendment could be made to the company's 2011/12 self-assessment which related to the same issue as that which had been determined by the section 54 agreement;

(5) as a result HMRC could have no reasonable grounds for continuing the enquiry;

(6) "in taxation you have to look simply at what is clearly said. There is no room for any intendment; there is no equity about a tax; there is no presumption as to a tax; you read nothing in, but you look fairly at what was said…". So said RowlattJ in *Cape Brandy Syndicate v CIR* 12 TC 358. That dictum, which related to the way one approached the language of a tax statute, also applied to the construction of Mr Musgrove's letter. What he had agreed was that there should be no extra amount assessed;

(7) Mr Musgrove's letter gave rise to a legitimate expectation on the company's behalf that the return was accepted and that there would be no further challenge to its position. HMRC in the enquiry were bound by the effect of that expectation: they could not come to any conclusion other than that no

amendment should be made. Since no amendment could be made there was no reasonable purpose in continuing the enquiry.

16. Mr Shea argued:

(1) that the enquiry into the company's 2011/12 tax return had just started. The enquiry could be into any aspect of the company's return;

(2) Mr Laurie had sought documents and information which could reveal errors in various aspects of the companies return: the scope of the enquiry was not limited to the calculation of the company's gross profit;

(3) whilst it was accepted that an agreement had been made for the purposes of section 54 in relation to the 2011/12 discovery assessment, what Mr Musgrove had agreed was that the principle of continuity was insufficient evidence for the making of the assessment;

(4) the prohibition on relitigation which arose from the decision in *Cenlon* related to a specific agreement. Whilst section 54 might thus preclude an additional assessment on the basis of the facts and law applicable to the point which was agreed, it could not preclude an assessment on the basis of new information;

(5) the information notice could give rise to new information which could therefore justify an amendment to the return;

(6) Mr Laurie already had information that the suppliers had continued their previous practice in 2011/12, and of the figure for the value of the supplies to the company. The resultant aggregate purchases were greater than those declared in the company's accounts. It was reasonable to continue to enquire into this difference; and

(7) as a result HMRC has reasonable grounds for not giving a closure notice until some time after it had received the information sought.

The relevant legislation.

17. Paragraph 24 Schedule 18 FA 1998 provides that an enquiry may be opened into a company's return by notice to the company, generally within 12 months after the delivery of the return.

18. There was no dispute that an enquiry into the 2011/12 return had been properly opened under this provision.

19. Paragraph 32 of schedule 18 explains that an enquiry is completed when an officer by notice informs the company he has completed his enquiry and states his conclusion.

20. Paragraph 33 of schedule 18 provides that

"(1) The company may apply to the tribunal for a direction that an officer of Revenue and Customs gives a closure notice within a specified period.

(2)…

(3) The tribunal shall give a direction unless satisfied that an officer of Revenue and Customs has reasonable grounds for not giving a closure notice within a specified period.

21. Mr Shea accepted that this provision placed the onus on HMRC to show that the continuation of the enquiry was reasonable.

22. Paragraph 31A Schedule 18 provides that at any time when any enquiry is in progress a question arising "in connection with the subject matter of the enquiry may be referred to the tribunal for determination". Paragraph 31D provides that the determination by the tribunal of such a question is binding on the parties in the same way as a decision on a preliminary issue in an appeal, and that the determination shall be taken into account by an officer of HMRC in reaching his conclusions on the enquiry.

23. Paragraph 41 provides that a "discovery assessment" may be made where an officer of HMRC discovers that an assessment the tax is insufficient. Paragraphs 42 to 44 restrict the circumstances in which such an assessment may be made.

24. Section 50(10) TMA provides that where an appeal is notified to the tribunal, the decision of the tribunal on the appeal is final and conclusive (subject to onward rights of appeal and presently irrelevant exceptions in section 50(11)).

25. Section 54 TMA and provides that:

"Subject to the provisions of this section, where a person gives notice of appeal and, before the appeal is determined by the tribunal, the inspector ... and the appellant come to an agreement, whether in writing or otherwise, that the assessment or decision under appeal should be treated as upheld without variation, or as varied in a particular manner or as discharged or cancelled, the like consequences shall follow for all purposes as would have ensued if, at a time when the agreement was come to, the tribunal had determined the appeal and had upheld the assessment or decision without variation, as varied in that manner or had discharged it or cancelled it as the case may be."

The section permits the taxpayer 30 days in which to resile from the agreement.

Discussion

26. In *Cenlon* there had been an agreement as respects two fiscal years between the taxpayer and the inspector that particular dividends should not be included in the company's taxable profit. A new inspector subsequently concluded that the dividends should have been taxable both in those two years and in a later year. A Special Commissioner and the High Court held that as regards the two years for which the agreement had been made, the precursor to section 54 precluded the making of a discovery assessment, but that the assessment might be made for the third year. In the Court of Appeal, Upjohn LJ, with whose conclusions Donovan and Pearce LJ J expressed concurring views said:

"In my judgement, if we were to give effect to the submissions made on behalf of the Crown, we should be rendering Section [50(10)] completely nugatory; and, what is equally important, it was quite futile and unnecessary to pass Section [54], for in essence the Crown would not be bound until the passing of six years, and they could always reopen any assessment upon a change of mind as to the law applicable. It seems to me that Section [50(10)] is directed to the case where a particular point has been determined, and when that point is determined it cannot be relitigated; both sides are bound. So with section [54], when a particular point has been agreed the parties are bound subject only to locus poenitentiae given to the subject but not the Crown under subsection (2). If they are bound, both sides must be bound: and it cannot be open to the Crown, under the guise of an additional assessment under [paragraph 43], to relitigate the very point, and in this case the only point, that has been agreed between the parties. On that short ground I would agree with the decision of the Judge and of the Commissioners."

The case continued to the House of Lords but no point was taken there on this issue.

27. That case was considered by the Court of Appeal in *Scorer v Olin Energy Systems* [1985] AC 645. The taxpayer had appealed against an assessment and also produced a computation of profit claiming a deductible loss. The loss had arisen in part of the taxpayer's business called the shipping division while the profits had accrued in part of the taxpayer's business called the airbreaker division. The taxpayer claimed to set off the loss against the profits. The appeal was compromised when the inspector said he agreed to the taxpayer's computation. The question was whether that agreement precluded the Revenue from raising a subsequent discovery assessment when they changed their mind about the correct tax treatment of the loss. Lord Keith, with whom the other members of the House agreed, said:

"It was settled by Cenlon Finance Co. Ltd, v. Ellwood [1961] Ch. 50; [1961] Ch. 634 that where an agreement has been arrived at under section [54] it is not open to the inspector to make an additional "discovery" assessment under [paragraph 43].Such an additional assessment is, however, not precluded if it is founded upon a point other than the particular matter which was the subject of the section [54] agreement. (See the Cenlon, case, per Cross J., at p. 69, Upjohn L.J., at p. 651, and Holroyd Pearce L.J., at p. 655; Kidston v. Aspinall (1963) 41 T.C. 371, per Wilberforce J., at p. 386; Chancery Lane Safe Deposit and Offices Co. Ltd, v. Inland Revenue Commissioners (1965) 43 T.C. 83, Banning v. Wright (1972) 48 T.C. 421.) In the present case the additional assessment dated 17 July 1972 was based upon the proposition that in law the carried-forward losses of the defunct Shipping Division were not available to be set against the profits of the Airbeaker Division for the accounting year to 30 November 1978. The question at issue is whether or not the availability of these losses for that purpose is the particular matter which was the subject of the section [54] agreement arrived at on 8 January 1970. By his letter of that date the inspector stated: "Your computations are therefore agreed for the chargeable accounting period ended 30 November 1968 . . ." These computations plainly included the

calculations which I have quoted, showing the set-off of section 345 brought-forward losses against the profits of the Airbreaker Division. These losses were in fact losses of the defunct Shipping Division. Counsel for the appellant argued, however, that the accounts and computations did not make this plain, that the provenance of the brought-forward losses was not clearly indicated, and that the inspector then dealing with the matter might have thought or assumed that they arose in the Airbreaker Division itself. In the circumstances the point now at issue was not in contemplation at the time. Reference was made to a passage in the judgment of Harman L.J. in the Chancery Lane Safe Deposit case, [1965] 1 W.L.R. 239, 247, where he said: "the point now in issue was not then raised nor was the question in the minds of either of the parties" and to another in the judgment of Wilberforce J. in Kidston v. Aspinall (1963) 41 T.C. 371, 388: "the question as to the right of the appellant's wife to take capital out of the settlement was not present to the minds of either the appellant or the special commissioners, and no possibility of an assessment following upon that right was ever discussed or ever raised."

In my opinion there can be no doubt that Olin's accountants were aware that they were putting forward a claim to have the carried-forward losses of the defunct Shipping Division set against the profits of the Airbreaker Division for the year in question. They clearly knew that the brought-forward losses of £465,457 shown on the final page of their computations had arisen wholly in the Shipping Division. I am further of opinion that the material which they put before the inspector was sufficient to bring home to the mind of an ordinarily competent Inspector in his position precisely what they were claiming. The accounts made it entirely clear that the Shipping Division had ceased to trade and had no profits in the year in question. The comparative figures for the year to 30 November 1977 included therein showed a substantial compensation payment received in respect of capital loss arising on the sale of m.v. Morven, and also an item, in the Shipping Division profit and loss account, in respect of disposal expenses. The nature of the losses claimed was made plain by the reference to section 345 of the Act of 1952, and they were claimed in a computation separate from that relating to the Airbreaker Division itself. I can see grounds for an assumption that the losses claimed related to the Airbreaker Division specifically. Reference to earlier accounts, which the inspector must have had in his possession, would have made it even clearer that they did not."

28. This passage in turn was noted by Lewison LJ in *Hankinson v HMRC* [2011] EWCA Civ 1566 when he said:

"[32]… the question before the House was whether [the] agreement precluded the Revenue from raising a subsequent discovery assessment when they changed their mind about the correct tax treatment for loss. Thus the question concerned the scope of the agreement. That in turn was in effect a question of construction…"

He then quoted part of the passage quoted above from Lord Keith judgement where he said that the situation must be viewed objectively and with regard to whether it would lead a reasonable man to the conclusion that inspector had decided to admit the claim. It seems to us that this is the answer to Mr Fengs's argument at [15(6)] above: on the authority of the Court of Appeal and the House of Lords, the test is not simply clear words but what a reasonable man knowing the circumstances would conclude was the purpose of the agreement.

29. The amendment of an assessment on the conclusion of an enquiry is not the same as making a discovery assessment. But it does not seem to us that that difference affects the principle that what has been determined by a tribunal decision should not be relitigated. That is the clear purpose of section 50(10) TMA. The same must be true of something deemed to have been so determined by section 54.

30. We find confirmation of this legislative intent in the provisions of paragraph 31A to G dealing with the referral of matters to the tribunal during an enquiry. Such a referral is not technically an appeal and thus falls outside the prescription of finality in section 50(10): the legislature in enacting paragraph 31G - providing that the determination is binding, is to be taken into account by the officer in his conclusions, and may be reopened only in very limited circumstances - indicates the legislative intent to preserve the prohibition against relitigation.

31. We therefore conclude that where a particular matter has been agreed on an appeal against an assessment for a particular year, the subject matter of that agreement binds the parties and must be taken into account by the officer in closing any enquiry for that year.

32. As a result, if: (1) the subject matter of the 2011/12 enquiry into the company's return were limited to the suppression of purchases and the consequent re-estimation of the gross profits of the company; (2) there were an agreement between the company and HMRC which resulted from and followed the discovery assessment; and (3) the subject matter of that agreement between Mr Musgrove and the company were the accuracy of the figures for purchases, sales and gross profits in the 2011/12 return, then it would not be open to the Mr Laurie to close the enquiry on any basis other than that of that agreement. That in turn would mean that there would be nothing which could result from the enquiry other than the making of no amendment. In those circumstances it would, we agree, not to be reasonable for the revenue to continue the enquiry.

33. However such conclusion depends upon there being an agreement between the company and Mr Musgrove and upon a particular construction of the agreement between Mr Musgrove and the company.

34. So far as (1) is concerned it seems to us to be satisfied: Mr Laurie fairly and frankly said that his concern in the enquiry was the suppression of purchases, the consequent suppression of sales and the resultant understating of profit. It extended no further than that.

35. So far as (2) is concerned, Mr Shea accepted that Mr Musgrove's letter gave rise to an agreement between the company and Mr Musgrove as regards the subject matter of the discovery assessment. We think he was right to do so even though the company did not formally assent to Mr Musgrove's conclusion as regards 2011/12. That there was an agreement can, in our view, be seen in the combination of the company's assertions on its appeal against the assessment and Mr Musgrove's conclusion that it should be reduced to nil.

36. What then was the point in question which was determined by that agreement? What was the scope of the agreement?

37. In our view it was that a presumption of continuity did not justify the additional assessment. It was not the wider agreement that the company's profits were precisely those shown on the return or that profits had not been suppressed. That to our mind is evident from Mr Musgrave's statements that there was insufficient evidence for the assessment and that he had taken into account the issue over the presumption of continuity. Those statements together lead us to conclude that a reasonable man would not conclude that Mr Musgrove had agreed that the company's profit was correctly reported and that the agreement of Mr Musgrove was limited to agreeing that one could not presume continuity.

38. Therefore the conclusion at [32] above does not apply, and it would be open to HMRC, if they had, and on the basis of, appropriate evidence, to conclude at the end of the enquiry that the profits of the company exceeded those on the return and that an amendment to the return should be made. There is therefore a point in the enquiry.

39. It seems to us reasonable that HMRC should seek to determine whether there is any understatement of those profits. Its ability with any accuracy to do so it depends upon the receipt of information. Until they receive that information, or know that they will not, or that they are sufficiently unlikely not to, receive it, it is unreasonable to expect them to conclude the enquiry within a particular time.

40. Mr Feng's argument about legitimate expectation at [15(7)] above does not dissuade us from this conclusion. Any legitimate expectation the company had as a result of Mr Musgrove's letter was limited to what a reasonable person would understand was the subject matter of what had been agreed under that letter. That was not that there could not be any further challenge to the company's returns.

41. We therefore conclude that HMRC have shown that it is reasonable for them to continue the enquiry.

Conclusion

42. We make no direction under paragraph 33.

Rights of Appeal

43. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 10 July 2014