TRAVERS SMITH

Tax Investigations Update

September 2021

Introduction

It has been a busy period for the Supreme Court in the area of tax disputes since our last update. As well as the important, long awaited decision in *Tooth* in relation to whether discovery assessments can be invalid due to "staleness", the Court has also issued a notable judgment (in *Haworth*) clarifying that the situations in which HMRC can issue follower notices are far more restricted than HMRC previously believed and considered the application of the legal principle of estoppel by convention to a taxpayer seeking to rely on a procedural formality to render an HMRC enquiry invalid (in *Tinkler*). These cases are summarised in this update, along with two further decisions from the Upper Tribunal (*Dodika* and *Cooper*) which will also be of interest to taxpayers.

How we can help

As one of the largest teams of tax lawyers in the City, we have extensive knowledge advising on disputes with tax authorities and early stage enquiries. With the vast majority of HMRC enquiries or investigations concluded well before litigation, our focus is seeking swift and decisive resolutions, whilst protecting our clients' commercial interests.

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Development	Summary	Why does it matter?
***Tooth* – discovery assessments and 'staleness'**	In an important decision, the Supreme Court in *Tooth*, held unanimously that, contrary to earlier case law, there is in fact no concept of "staleness" in relation to discovery assessments. For more detail on the decision please our briefing on *Tooth*.	Taxpayers have lost 'staleness' as a potential protection against inaction by HMRC in investigating their affairs. HMRC are bound only by the express statutory conditions in order for a discovery assessment to be valid. Therefore, provided that HMRC act within the time limitations set out in statute, the fact that a 'discovery' may have taken place long before a discovery assessment is actually raised is no longer relevant. ***Travers Smith have also authored an opinion piece in Tax Journal on the Supreme Court decision and the implications for taxpayers, which is available to view here.***
***Haworth* – follower notices**	In an important victory for the taxpayer, the Supreme Court has ruled that the circumstances in which a Follower Notice (FN) can be issued are far narrower than HMRC had believed. FNs are a significant tool used by HMRC to counteract tax-avoidance schemes and, broadly, can be issued where HMRC believes that there has been a final judicial ruling (relating to somebody else) the principles or reasoning from which "would", if applied to the taxpayer's arrangements, deny the taxpayer the tax advantage they are seeking. If the recipient of a FN does not take corrective action, they risk heavy penalties unless they ultimately succeed before the courts in relation to the claimed tax advantage. Although, when FNs were introduced, many thought they would only apply where the taxpayer's chance of the courts reaching a different decision from the previous ruling were remote, HMRC have been enthusiastically deploying them. However, in Haworth, the Supreme Court found that HMRC had been applying an incorrect threshold. A mere opinion that a relevant ruling is likely to deny a taxpayer an advantage is not sufficient. Rather, the relevant word in the legislation *"would"*, means that there is no scope for a reasonable person to disagree that the earlier ruling denies the taxpayer the advantage. The Court set out factors for assessing whether the threshold is met, including how fact-sensitive the application of the previous judicial ruling is.	The decision is a welcome one for taxpayers, significantly reducing the circumstances in which FNs can be used. In reaching its conclusion on what threshold to apply, the Court was influenced by the severity of the consequences for taxpayers of FNs if they continue to pursue their appeal against HMRC, which thereby has the effect of restricting access to the courts. The Supreme Court's judgment should mean that HMRC's use of FNs is limited to be more in line with what many consider to be their original purpose, i.e. preventing users of a mass-marketed tax avoidance scheme that has been defeated in relation to one of them prolonging their dispute with HMRC by re-arguing points. Taxpayers who have received FNs should consider whether to challenge them. Taxpayers will also be interested that the Supreme Court found for HMRC in holding that (i) factual findings in a judgment can form part of the principles laid down or reasoning given in it; and (ii) the FN was, on the facts, still valid despite not adequately explaining why the previous judgment applied to Mr Haworth's circumstances.

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***Tinkler* – taxpayer prevented from arguing that enquiry notice sent to wrong address was invalid**	A notice of enquiry must be sent to a taxpayer's *"usual or last known place of residence"*. However, when HMRC initially opened an enquiry into Mr Tinkler's 2003/4 tax return in July 2005, it was addressed to a previous address of his. A copy was also sent to Mr. Tinkler's tax advisers, who confirmed receipt and began corresponding with HMRC in respect of the enquiry. Several years later, after HMRC had concluded its enquiry and decided that he was not entitled to certain losses claimed in his return, Mr Tinkler argued that the enquiry was invalid due to the original notice having been sent to the wrong address. However, the Supreme Court has now found in HMRC's favour, holding that Mr Tinkler was prevented (as a result of the legal doctrine of "estoppel by convention") from arguing that the notice was invalid.	If a taxpayer wants to challenge the validity of an HMRC enquiry notice, that challenge should be carried out promptly, as, if a taxpayer begins to correspond with HMRC in respect of an enquiry, this case demonstrates that the Court is likely to be slow to infer that a valid notice has not been served.
***Dodika* – 'reasonable details' in tax covenant claim**	In our 2020 Autumn update we reported that the High Court had held that a notice of claim given under a tax covenant was not valid as it did not comply with a contractual requirement to contain "reasonable detail" of the matter giving rise to the claim. The Court of Appeal has now overruled that decision, finding that the knowledge of the sellers could be taken into account in determining whether the buyer had given reasonable detail in the notice of claim. In the case, the seller had full knowledge of the details of the relevant tax investigation. In reaching its decision, the Court noted that *"if a contract does prescribe that certain information must be included, a notice which fails to do so will be invalid and it will be no answer to say that the recipient already knew it"*, but said that, in this case, the purchase agreement did not specify the information that the notice needed to contain, simply that reasonable detail must be provided. What constitutes reasonable detail for these purposes will depend on the circumstances of the case, which, in the view of the Court of Appeal *"must include in particular what is already known to the recipient"*.	Although the decision means that a seller's knowledge can, in principle, be taken into account for the purposes of determining what is reasonable detail in a notice of claim, it is noteworthy that, ultimately, the point will depend on the specific facts and circumstances of a particular case. Accordingly, good practice for those issuing notices of claim under tax covenants remains: • to ensure that the notice complies with all of the conditions for validity contained in the relevant contractual agreement; and • where the contractual requirement is to provide "reasonable" information, adopt a prudent approach and provide fuller rather than brief details of the claim (including the underlying tax issue).

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***Golamreza Qolaminejite (aka A Cooper)* – taxpayer must show overcharge of tax on balance of probabilities in appeal against HMRC assessments**	In *A Cooper* both parties agreed that the burden of proof to show HMRC's assessment was incorrect was on the taxpayer, and that the standard of proof was the civil one – the balance of probabilities. They differed, however, on how this should be applied. Mr Cooper argued that the tribunal was required to take HMRC's argument and his and decide which was, on the balance of probabilities, the correct one. The Upper Tribunal did not agree. HMRC, it concluded, is not required to do anything – the burden is on the taxpayer to show that, on the balance of probabilities, it has been overcharged to tax. This will involve the taxpayer putting forward a proposition ('X') which demonstrates that the assessment to tax is incorrect. The tribunal simply has to consider which is more probable: 'X' (as argued by the taxpayer), or 'not X'. There is no requirement on HMRC to put forward any arguments or evidence to prove its own case – if it wishes, HMRC is entitled to put forward no argument at all. In the words of the Upper Tribunal, it is the taxpayer which is required to *'do the running on showing X is more likely than "not X"'*.	This case provides a helpful summary of how the burden and standard of proof operates in the context of appeals against HMRC assessments. It is clear that there is no requirement for HMRC to prove to the tribunal that an assessment to tax is correct. The burden of proof is firmly on the taxpayer to show that, on the balance of probabilities, it has been overcharged to tax.