Knowing when there is an enquiry: form over substance?

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The importance of HMRC making clear its intention to enquire into a taxpayer's return has wide-reaching implications for taxpayers and HMRC alike. The recent tribunal decision in *Credit Suisse Securities* provides important guidance on when notice of enquiry is and is not given by HMRC. In particular, the tribunal confirms that a clear distinction exists between 'informal enquiries' made by HMRC into self-assessed returns (or indeed ongoing transactions or arrangements) and those which are 'formal enquiries'. If HMRC intends to shift the discussion from informal enquiries to a formal enquiry, it must actually give notice of its intention to enquire to the taxpayer.

Procedural issues inevitably attract less interest from tax teams (or perhaps CCMs) than the substantive or technical issues, not least because most people involved prefer to reach a technically sound resolution without resorting to formal proceedings. However, the importance of procedural issues should not be underplayed: if enquiries and assessments are not validly opened, raised and/or closed, the foundations on which HMRC can assert that a tax liability exists can crumble.

In cases brought by HMRC and taxpayers alike, recent leading decisions have placed increased focus on the validity of HMRC enquiries, closure notices and discovery assessments. By way of example, in *Tinkler v HMRC* [2019] EWCA 1392, the Court of Appeal held that a closure notice for a purported tax enquiry was invalid because the underlying enquiry had not been validly opened: the notice had been sent to the wrong address, and the taxpayer was not estopped from contesting this. In a similar vein, there is the separate case law on discovery assessments, which has produced several important decisions in the last ten years (including *Tooth v HMRC* [2019] EWCA Civ 826), and where there remains uncertainty over whether a discovery can become 'stale'. Sadly, for space reasons, that is outside the scope of this article.

Instead, we focus on the importance of opening an enquiry properly, which was recently emphasised in the First-tier Tribunal decision in *Credit Suisse Securities (Europe) Ltd & Others v HMRC* [2020] UKFTT 86 (TC) (*Credit Suisse*), in which we advised the taxpayers. The *Credit Suisse* case concerned the application of bank payroll tax (or BPT) to certain deferred variable awards made to senior employees by the Credit Suisse group (or CS). BPT was a one-off tax imposed by FA 2010 Sch 1 on bank bonuses, so the specific technical facts of the case are largely of historic interest only. The notice of enquiry provisions tested in *Credit Suisse* (in the context of BPT) were virtually identical to the provisions in TMA 1970 s 9A for income tax and FA 1998 Sch 18 para 24 for corporation tax, so the decision on these points is of much broader application. The key question was whether HMRC had validly given notice of enquiry within the statutory 12 month time limit, which expired on 31 August 2011. Applying existing legal principles, as established by the Court of Appeal in *Langham (Inspector of Taxes) v Veltema* [2004] EWCA Civ 193 (*Langham*) and *Raftopoulou v HMRC* [2018] EWCA Civ 818 (*Raftopoulou*), to the facts in Credit Suisse's case the tribunal found as a matter of fact that HMRC had not done so, with the result that the closure notices assessing CS to additional BPT were invalid.

Notice of enquiry: the key propositions

The start of any enquiry requires notice to be given by HMRC. In *Credit Suisse*, Judge Guy Brannan summarised and applied some of the key

propositions from the leading Court of Appeal authorities on notice of enquiry, including *Langham* and *Raftopoulou*. While doing some damage to Judge Brannan's more comprehensive review of the relevant principles, these propositions can be conveniently divided into five core points:

1. Objective test

Whether or not a notice of enquiry has been given is an objective test. To be effective, an enquiry notice must be understood by a reasonable person in the position of the intended recipient (the taxpayer in this case), having that person's knowledge of any relevant context, as giving notice of an intention to enquire into a return. The application of this objective test is a question for the tribunal to determine, taking account of relevant evidence and circumstances. In doing so, the tribunal should construe the legislative words on the page, rather than searching for any substitute for the phrase 'enquire into' used in the legislation.

2. Certainty

Parliament must have intended HMRC and taxpayers to have had certainty as to when an enquiry had been opened. That follows from the consequences of opening an enquiry (or not) but also from the principle that, usually, HMRC will not open an enquiry without considering available materials and following a decision-making process that accords with broader public law principles. (In this regard, it's worth remembering the ongoing discussion regarding HMRC's proposals in respect of widening their civil information powers, and questions raised by the Treasury Select Committee last year on how HMRC handle disputes.) Therefore, there can and arguably should be consideration *before* the decision is taken to open an enquiry, not that the enquiry *starts with* such consideration. Under the scheme of the BPT legislation, the notice precedes the enquiry under para 23 and so alerts the taxpayer to the start of a formal process.

3. Degree of formality

There is no prescribed form for an enquiry notice but (i) it must be clear from the notice that HMRC intends to enquire into the return; and (ii) the enquiry provisions suggest a procedure with some degree of formality and also suggest a procedure with a beginning, a middle and an end. There is a balance struck in the various statutory provisions that allow, but do not oblige, HMRC to 'enquire into' a return.

4. Statutory consequences

The opening of an enquiry has significant statutory consequences, including the right of HMRC to call for information and/or documents for the purpose of its enquiry (see FA 2010 Sch 1 paras 23(5) and 36). In this regard, it's worth remembering that in *Raftopoulou*, it was HMRC that argued no enquiry had been opened. Clearly these provisions cut both ways.

5. Formal enquiry is not informal questioning

As Auld LJ explained in *Langham* (at paras 31-32), there is a distinction between, in the context of self-assessment returns, 'light monitoring' by HMRC and the exercise of its statutory power of enquiry. In that case, reference was further made to 'an intermediate and possibly time-consuming scrutiny, *whether or not in the form of an enquiry under s 9A*' (emphasis added). There is a distinction between informal enquiries and the opening of an enquiry into a claim under FA 2010 Sch 1 para 23 with its attendant statutory powers.

Practical lessons: certainty and consequences

These propositions are, in many respects, uncontroversial. However, applied to the day to day operations of many taxpayers, they will be welcome. Above all, they demonstrate that the tribunal has regard for the certainty taxpayers need as to when an enquiry is in train and the consequences that brings for HMRC and taxpayers.

In terms of certainty, it is critical that taxpayers know when there is a potential amendment to their tax return and when they have certainty that there will not. For instance, so accounts can be finalised, provisions made or released and investors or markets updated. If it were the case that mere disagreement (even if reasoned) or the raising of further queries by HMRC were sufficient to constitute notice of enquiry, sophisticated taxpayers would find themselves querying whether a conversation with HMRC or part of a letter from HMRC had inadvertently opened formal enquiries. More fundamentally, this would (a) create the theoretical possibility of multiple notices being given in respect of the same enquiry each time HMRC indicated disagreement with or raised queries to clarify the taxpayer's view, and (b) mean no meetings or calls could sensibly take place with HMRC without taxpayers taking the reasonable precaution of having verbatim transcripts taken. This would be an unsatisfactory and unworkable position for all concerned, and it would likely have a detrimental impact on the intended open and transparent relationship of sophisticated taxpayers with HMRC (see, for example, the code of practice on taxation of banks (5 December 2013) in the context of financial services institutions and banks).

Further, if an enquiry is opened, it is opened into all aspects of a return, and remains open indefinitely until closed. So (on HMRC's case in *Credit Suisse*) taxpayers could find that, if HMRC informally queried one issue in their return shortly after filing, this could mean that all aspects of the return remain open forever until HMRC issue a closure notice (which, of course, they would not do if nobody thought at the time that an enquiry was opened). Evidently, this could work against HMRC, too, because of taxpayers' powers to amend their return during an enquiry.

The certainty that Parliament must have intended is given by HMRC being shut out from making amendments to a tax return unless they commence formal enquiries within the relevant time period.

As in *Credit Suisse*, HMRC has no statutory power to amend the taxpayer's return by issuing closure notices if a formal enquiry has never been effectively opened. Of course, HMRC may seek to issue discovery assessments; however, discovery assessments require a separate, strict legal test to be met by HMRC (see, for example, FA 1998 Sch 18 paras 41–45). Discovery assessments do not therefore necessarily represent HMRC's 'cure' should notice not be given or effective. As above, the Court of Appeal have made clear that the insufficiency of the tax must be newly discovered (*Tooth*).

In terms of consequences, a formal enquiry triggers (i) statutory rights for the taxpayer; and (ii) statutory powers for HMRC, the balance of which has been set by Parliament. For example, during a formal enquiry, a taxpayer may refer questions to the tribunal for determination or seek a direction from the tribunal that HMRC gives a partial or final closure notice (FA 1998 Sch 18 paras 31A and 33). By the same token, during a formal enquiry, HMRC has the statutory powers to call for information and/or documents from the taxpayer for the purpose of HMRC's enquiry (FA 2008 Sch 36 para 21) (as indeed was commented upon by the tribunal in *Credit Suisse*; see para 178). It is therefore important that both HMRC and the taxpayer understand exactly when their statutory rights and powers can be exercised.

Formal versus informal discussions

To the extent sophisticated taxpayers deal with HMRC on a 'real-time' or 'ongoing' working basis, issues or follow- up points in past or soon to be filed returns are regularly raised by both the taxpayer and HMRC as part of their ordinary dealings and relationship management. Should HMRC wish to pursue a particular issue beyond an initial discussion, informal enquiries by HMRC may range from 'light monitoring' to 'intermediate and possibly time- consuming scrutiny' (*Langham*, at paras 31–32). Such informal enquiries may include a line of correspondence or oral discussions between the taxpayer and HMRC during which

HMRC indicate disagreement with the views of the taxpayer or raise further queries for clarification. As many taxpayers and advisers will know, this ability to engage with HMRC about points of potential difference can be a very constructive way to resolve issues without recourse to formal dispute.

However, as was made clear in *Credit Suisse*, should HMRC wish to shift the discussion from informal enquiries to a formal enquiry, they must go further. This is consistent with the emphasis given by David Richards LJ in *Raftopoulou* (para 34) to the point that it must be *clear* from the notice that HMRC intends to enquire into the claim. (It's a little unfortunate that the court in *Raftopoulou* referred to both the formal and informal processes as 'enquiries' but this doesn't change the substance of the decision.) Judge Brannan confirmed in *Credit Suisse* that it therefore follows 'that a notice of the intention to enquire into a return cannot be regarded as validly given to a taxpayer by inference or implication'. Rather, the reasonable taxpayer with the subjective knowledge of the taxpayer in question needs to understand clearly, and not be left guessing, that HMRC is giving notice of enquiry at a particular point in time because of the important consequences flowing from a shift to a formal enquiry. Given the important consequences that flow from such a shift, the best method for HMRC to adopt to ensure there is no ambiguity or misunderstanding is to expressly state to the taxpayer that HMRC is opening, or intends to open, an enquiry into a taxpayer's return, and (even if just for evidential purposes) to record that statement in writing. For the same reason, the importance of contemporaneous record-keeping by taxpayers should be self-evident. In that regard, reserving the position on a procedural point does not prevent continuing a constructive and open dialogue with HMRC; it simply preserves the balance of powers prescribed by Parliament. In our experience, taxpayers should reserve the position expressly on procedural points as soon as they are identified (even while continuing the substantive debate), rather than only challenging the procedural position in a tribunal appeal, so as to mitigate the risk of an estoppel challenge to the (potentially determinative) procedural arguments from HMRC.

Conclusion

Credit Suisse confirms that an important distinction exists between 'informal enquiries' made by HMRC into self-assessed returns (or indeed ongoing transactions or arrangements) and those which are 'formal enquiries'. In both scenarios, it is possible to have 'intermediate and possibly time-consuming scrutiny' of taxpayers' returns (per *Langham* at para 32); however, it is incumbent on HMRC to make clear if it intends to shift the discussion from informal enquiries to a formal enquiry. In order for HMRC to do so, it must actually give notice of its intention to enquire to the taxpayer. *Raftopoulou* confirms (and *Credit Suisse* applies) the objective, legal test that must be met in order for notice of enquiry to be effective: the notice must be understood by a reasonable person in the position of the intended recipient (usually, the taxpayer), having that person's knowledge of any relevant context, as giving notice of an intention to enquire into the return. If it doesn't, the balance of power established by Parliament prevents HMRC imposing any additional tax liabilities.

The authors' firm acted for the taxpayer in this case.

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