2. Introduction to discovery assessments

2.1 Introduction

2.1.1 Historical context

The former Inland Revenue (now HMRC) long had a power to issue assessments upon discovering that taxpayers had paid too little tax. This power was not abolished when self-assessment was introduced (with effect from 6 April 1996).

Nevertheless, self-assessment provides HMRC with additional powers to review what taxpayers have done in their tax returns, most notably with the right to open a statutory enquiry (usually) within twelve months of the tax return being submitted. Once an enquiry is opened, HMRC have no statutory time limit for bringing it to a conclusion, although taxpayers have a right to ask the Tribunal to direct that an enquiry be closed within a specified period, a power that the Tribunal will not exercise if it considers that HMRC have good reason to continue their investigations.

2.1.2 Relationship with self-assessment

However, the additional burdens imposed on taxpayers under self-assessment led Parliament to limit the situations in which a taxpayer may be subjected to a discovery assessment. As the Court of Appeal held in *Tower MCashback*:

> "[Apart from the specific interventions permitted under the self assessment rules themselves,] the only other method by which the Revenue can impose additional tax liabilities or recover excessive reliefs is under the new s. 29. That confers a far more restricted power than that contained in the previous s. 29. … These provisions underline the finality of the self-assessment, a finality which is underlined by strict statutory control of the circumstances in which the Revenue may impose additional tax liabilities by way of amendment to the taxpayer's return and assessment."

Case: *Tower MCashback LLP v HMRC* [2010] EWCA Civ 32

2.2 Discovery assessments in practice

2.2.1 When discovery assessments arise

In the theoretical world, a discovery assessment is most likely to arise as a result of a self-assessment enquiry into a taxpayer in the course of which an error is identified. If HMRC have reason to believe that that the same (or a similar) error is likely to have occurred in another tax year, HMRC may well make a discovery assessment in respect of that other year.

There will also be situations in which HMRC newly come across information (for example a tip-off from a former spouse) that alerts them to a historical under-assessment. In such situations, a discovery assessment is likely to be appropriate.

Discovery assessments can also arise when HMRC (either as a result of legal developments elsewhere or simply as a genuine change of interpretation) consider that the law gives rise to a different outcome from that previously thought to be the case.

Finally (and worryingly commonly) there are situations in which HMRC have simply failed to open an enquiry in time (even in cases in which they were already investigating a taxpayer in respect of other years). In such cases, HMRC's only way of collecting any additional tax now thought to be due is by making a discovery assessment.

2.2.2 Dealing with a discovery assessment

In each case, although HMRC might well have identified tax that should have been assessed, in order to secure that additional tax, HMRC have had to demonstrate that the additional statutory conditions for a discovery assessment are met.

Indeed, most of the leading cases concerning discovery assessments have not involved any dispute as to the amount of tax that should have been paid: instead, the only dispute was whether the discovery assessment rules meant that the tax could still be demanded.

The discovery assessment rules, therefore, are a type of statutory limitation, peculiar to the tax code. In the same way as an individual should not hesitate to argue that a 20-year old debt (for example) is statute-barred, there is no reason why a taxpayer should not argue

that the statutory rules governing discovery assessments preclude HMRC from collecting a particular sum now thought to be payable. Indeed, in *Abdulla*, the Supreme Court has provided a reminder of the validity of such arguments:

> "… issues of limitation are bedevilled by an unarticulated tendency to treat it as an unmeritorious procedural technicality. This is, I think, unjustified. Limitation in English law is generally procedural. But it is not a technicality, nor is it necessarily unmeritorious. It has been part of English statute law for nearly four centuries. It has generated analogous non-statutory principles in equity. Some form of limitation is a feature of almost all other systems of law. And it has been accepted in principle in the jurisprudence of both the Court of Justice of the European Union and the European Court of Human Rights. Limitation reflects a fundamental and all but universal legal policy that the litigation of stale claims is potentially a significant injustice. Delay impoverishes the evidence available to determine the claim, prolongs uncertainty, impedes the definitive settlement of the parties' mutual affairs and consumes scarce judicial resources in dealing with claims that should have been brought long ago or not at all."

Case: *Birmingham City Council v Abdulla* [2012] UKSC 47

2.2.3 HMRC's approach to discovery assessments

In practice, however, HMRC often treat discovery assessments as simply another way of collecting tax that they consider to be due and pay little regard to the statutory hurdles that need to be overcome in such cases. Even when they are themselves aware of the restrictions, they sometimes fail to make it clear to taxpayers (or their advisers) how HMRC consider the statutory conditions to be met.

Consequently, many taxpayers will read HMRC's correspondence and take it at face value. For example, HMRC might explain why a particular expense was not deductible, but will fail to explain why they consider that they are entitled to go back seven years to assess it. In such a case, a taxpayer might not be aware of his right to argue that the original under-assessment was not due to deliberate

conduct and pay what is now being demanded (but what might not actually be due).

The Upper Tribunal's decision in *Burgess/Brimheath* should level things up slightly because it requires HMRC, at the Tribunal, to prove that each condition for a discovery assessment is indeed satisfied. However, most cases do not find their way to the Tribunal, meaning that it is incumbent on taxpayers or their advisers to ensure that HMRC stick to the rules.

Case: *Burgess v HMRC, Brimheath Developments Ltd v HMRC* [2015] UKUT 578 (TCC)

2.3 The ingredients of a discovery assessment

2.3.1 The basic conditions

These basic conditions are discussed in further detail in later chapters.

However, in summary, HMRC must first show that they have "discovered" an earlier underpayment. This is the test that long-predated the self-assessment rules. This is discussed in **Chapter 3** below.

Secondly (assuming that the taxpayer had filed a return for the relevant period), the changes introduced by self-assessment require HMRC to show, in addition, that they can overcome one (or both) of the following two hurdles:

- that the original under-assessment was attributable to the careless or deliberate conduct of the taxpayer (or a person acting on the taxpayer's behalf) (discussed in **Chapter 4** below); or
- that the tax return (and other documentation deemed to be before a "hypothetical tax officer") would not have been sufficient to alert the hypothetical officer to the under-assessment (discussed in **Chapter 5** below).

It must be emphasised that these additional safeguards do not apply to taxpayers who have not submitted a tax return for the relevant tax year. In those cases, the only procedural hurdle that HMRC need to overcome is to show that they have made a discovery.

2.3.2 Time limits

Unlike closure notices in the case of self-assessment enquiries, the statute imposes time limits on the issue of discovery assessments. HMRC are also required to demonstrate that these time limits have not been breached.

The time limits are discussed in **Chapter 7** below.

2.4 A statutory defence against a discovery assessment

Finally, the statute provides a further opportunity for a discovery assessment to be avoided. To do so, the taxpayer must be able to demonstrate that the original return (containing the under-assessment) was prepared in accordance with the then prevailing practice.

This defence is discussed further in **Chapter 6** below.

2.5 HMRC Statements of Practice

For completeness, it should be noted that HMRC have published two Statements of Practice which govern their approach to discovery asessments (SP 8/91 and SP 1/06). The first is nowadays of mainly historical relvance and focuses on the right of HRMC to make a discovery assessment in cases where a prior agreement has been reached between them and a taxpayer on a particular matter. The second represents HMRC's views on when HMRC can make a discovery assessment where information has previously been provided to HMRC but where there has not necessarily been any prior agreement by an officer.

These Statements of Practice are both rather out of date and of limited practical value. However, their text is analysed in **Appendix 1** and **Appendix 2** to this book.

Guidance: HMRC Statements of Practice 08/1991 and 01/2006

3. The meaning of "discover"

3.1 Introduction

The fundamental ingredient of a discovery assessment is that HMRC have "discovered" an under-assessment. This hurdle has long existed, pre-dating the self-assessment rules by many years.

Indeed, the principal definition of what is necessary to substantiate a discovery goes back over 100 years.

It should be noted that, despite a discovery being a fundamental ingredient to a discovery assessment, many practitioners and HMRC officers have wrongly assumed that the condition was abolished (or somehow watered down) when self-assessment was introduced, leaving only the two hurdles discussed in **Chapters 4 and 5** below.

3.2 What is a discovery?

3.2.1 What must be discovered?

Even this basic question can often be answered wrongly. For example, it is very common to see HMRC quoting from (or, worse, paraphrasing) the Upper Tribunal's decision in *Charlton* as follows:

> "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."

For the avoidance of doubt, the author has no issues with what the Upper Tribunal said in that passage. However, context is everything. The point is that s. 29(1) is very specific as to what must be discovered for the purposes of a discovery assessment. The discovery must be either:

- 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
- that an assessment to tax is or has become insufficient, or

- that any relief which has been given is or has become excessive.

These three situations are often abbreviated as "a loss of tax", which broadly (although not exactly) covers the statutory test.

The important point is that what is claimed to have been discovered must fall within at least one of those three descriptions. Otherwise, the purported discovery is simply irrelevant for the purposes of any assessment.

Example

Benjamin's 2015 tax return was submitted late on 15 March 2016. An HMRC officer discovers this fact on 10 November 2016.

Whilst learning that the tax return was late might well be a discovery in the general sense of the word, it is not a relevant discovery for the purposes of s. 29(1).

In short, HMRC need to discover that the tax that they seek to recover is indeed due to them.

Law: TMA 1970, s. 29(1)
Case: *HMRC v Charlton (and others)* [2012] UKUT 770 (TCC)

3.2.2 Facts and laws may be discovered

Under English law, there has traditionally been a distinction between fact and law. Although the distinction is continuously being eroded, it is still evident in the restrictions on matters that may be the subject of appeal from the First-tier to the Upper Tribunal.

With this distinction in mind, it was once argued up to the House of Lords that a discovery had to be of a fact and that learning the true meaning of a law could not form the basis of a discovery assessment. The underlying logic is that people in general (and tax officers in particular) are deemed to know the law. However, in *Cenlon*, the House of Lords emphasised that learning the true meaning of a law was as much a discovery as finding out a particular fact.

As Viscount Simonds held (with emphasis added):

> "I can see no reason for saying that a discovery of undercharge can only arise where a new fact has been