Discovery assessments

Can a discovery become stale, and therefore unable to support a discovery assessment, if made after too long a delay?

Two tribunal cases were recently published within days of each other on the subject of discovery assessments – one in the First-tier Tribunal, *S Miesegaes v HMRC* [2016] UKFTT 375; and another in the Upper Tribunal in *Pattullo v HMRC* [2016] UKUT 0270.

Both these cases dealt with the conventional arguments regarding what is a discovery, although the Upper Tribunal had a few robust things to say about the difficulties inherent in the requirement to consider the characteristics of a hypothetical officer. There was also the curious suggestion in *Miesegaes* that a taxpayer who makes adequate disclosure of all the relevant facts is not protected from a discovery assessment. That would seem to suggest that an adequate disclosure is somehow inadequate.

However, this particular conundrum will have to wait for another day. I want to concentrate on another interesting aspect of these cases – which was that both the tribunals, completely independently, examined the comparatively new concept that a discovery may become stale and therefore unable to support a discovery assessment, if it is made after too long a delay.

The argument was that if HMRC makes a discovery but waits too long before raising its discovery assessment, it should be debarred from doing so. Obviously, HMRC has to raise its discovery assessment within the relevant statutory time period. The suggestion, though, was that sometime before the expiry of the statutory time limit, HMRC could run out of time on the basis of staleness.

The First-tier Tribunal in *Miesegaes* said in clear terms that there is no concept of staleness of a discovery. A discovery can take place at any time, even before the enquiry window has closed; and the only time limitation for making the discovery assessment is the statutory time limit contained in TMA 1970 s 34.

However, the Upper Tribunal in *Pattullo* took rather a different view. It said that there is a need for the discovery to be acted upon while it remains fresh; and this is something which arises from the natural meaning of s 29(1). The Upper Tribunal said in particular: 'It would, to my mind, be absurd to contemplate that having made a discovery of the sort specified in s 29(1), HMRC could in effect just sit on it and do nothing for a number of years before making an assessment just before the end of the limitation period specified in s 34.'

It is a pity that the Upper Tribunal provided no further guidance on this point. Indeed, the judge went on to say:

'I do not think it would be helpful to try to define the possible circumstances in which a discovery would lose its freshness and be incapable of being used to justify making an assessment.'

I would respectfully disagree. I think it would have been extremely helpful if the Upper Tribunal had tried to define the circumstances in which a discovery would fatally lose its freshness. It would be of great interest and value to taxpayers. As it happened, the facts in *Pattullo* were such that the discovery had not become stale by the time the discovery assessment was made, so that the issue did not have to be taken further. However, having regard to this clear conflict (and the uncertainty which now exists over the concept of staleness), this issue is bound to arise again before too long. ■

Peter Vaines, Field Court Tax Chambers (pv@fieldtax.com)

King rules on partnership tax dispute

The mechanics of the taxation of partnership profits are in principle simple – deceptively so.

The partnership (or, more precisely, a designated member on behalf of the partnership) makes a partnership tax return. That return states both the amount of the partnership's taxable profit and how it is allocated between the partners. Each partner takes the figure allocated to him on the partnership return, inserts it into his tax return and pays tax accordingly. What could possibly go wrong?

Well, what happens when a partner considers that the figure of taxable profit allocated to him in the partnership is incorrect? Is he required to hold his nose and include it in his return without comment? How can that be consistent with his signing the declaration on his return that it is to the best of his knowledge correct and complete?

The question was previously considered in *Morgan and Self v HMRC* [2009] UKFTT 78 (TC). Because the case was decided on other grounds, the judge's comments on the point were *obiter dicta* but nonetheless persuasive, and they have informed HMRC's published guidance:

'where there is a genuine disagreement that cannot be resolved between the partners, individual partners should:

- enter, as their share of partnership profits, the amount they consider to be correct; and
- advise us that they have done so by making an entry in the white space notes section of the return to show: the profits as allocated in the partnership statement; a deduction (or addition) of the disputed amount; and an explanation about why they think the profit allocated to them in the partnership statement is wrong.'

It may seem a little odd to find HMRC apparently arguing the point again in the recent case of *King and others v HMRC* [2016] UKFTT 409 (TC). Things are not quite that simple, however.

Where an enquiry into a *personal return* is completed, HMRC amends the return by issuing a 'closure notice', against which a taxpayer is entitled to appeal. Where an enquiry is made into a *partnership return* and on closure of that enquiry the partnership return is amended, any necessary consequential amendment is made to the tax return of any individual partners affected. It is now well established that an individual partner has no right to appeal against such a consequential amendment.

In *Morgan and Self*, there had been no enquiry into the partnership return: both the partnership and HMRC believed the return to be correct. The question was simply whether the individual partner was bound to make his or her return on the same basis and the answer was no.

In *King*, as in *Morgan and Self*, some of the partners in a partnership disagreed with the basis on which the designated member had filed the partnership return and they filed their own personal returns on a different basis. In *King*, however, HMRC had enquired both into the partnership return and also into the individual returns. So when the enquiries were closed, were the amendments to the partner's individual return being made by reason of a 'closure notice' relating to the enquiry into the personal return (which was appealable); or were they made by a 'consequential amendment' notice consequent upon the closure of the enquiry into the partnership enquiry (which was not appealable)?

The waters are muddied somewhat by the fact that, on closing the partnership enquiry, HMRC did not actually make any amendments to the partnership return, so it is difficult to see how any amendments made to the individual partners' returns could have been 'consequential amendments'. Nonetheless, HMRC argued that 'the amendments to the appellants' 2011/12 tax returns, because they implement an adjustment to a partnership return, are essentially [non-appealable] "consequential amendments"'.

The judge did not agree. The amendments were made pursuant to the closure of enquiries into the personal returns; there was a right to appeal against them; and, furthermore, the appeals would be upheld. ■

BKL Briefing (bkl.co.uk)