DISCOVERY FOLLOWING THE VELTEMA JUDGMENT

Self Assessment tax returns are usually issued to taxpayers in April, shortly after the end of the tax year. The Return has to be completed and sent in by the following 31 January. The Revenue can open an enquiry into that return within twelve months of 31 January to check that the self assessment returns the right amount of tax. If it is incorrect the self assessment can be corrected.

There are some circumstances in which the tax inspector can assess further tax after the twelve month enquiry period. This usually happens when tax was under-assessed because of fraud or negligence by the taxpayer but it can also happen if the taxpayer doesn't provide enough information for the inspector to realise within the enquiry period that the self assessment was insufficient.

The Court of Appeal judgment in a recent case, the Veltema case, was concerned with how much information the taxpayer needs to provide to remove the possibility of the inspector making a further assessment, known as a discovery assessment. This note provides some guidance on what taxpayers can do to reduce or remove the risk of a discovery assessment in some fairly common circumstances.

Valuation cases

Some entries on tax returns depend on the valuation of an asset. For example, if a company transfers a property to a director. There is no obligation on the taxpayer to do any more than enter the resulting benefit in the relevant box on the Return. The Help Sheet IR213 shows how to work out the benefit from the market value of the asset. Doing no more than that cannot give the inspector the level of information that the Court of Appeal says is necessary to prevent a later discovery assessment.

However, most taxpayers who state in the Additional Information space at the end of the Return that a valuation has been used, by whom it has been carried out, and that it was carried out by a named independent and suitably qualified valuer if that was the case, on the appropriate basis, will be able, for all practical purposes, to rely on protection from a later discovery assessment, provided those statements are true.

The main exception will be those, like the example of the property transferred to a director, where the same transaction is the subject of an agreed valuation in a later related tax return, that of the company. It may then be possible that the earlier director's return was insufficient. It is also likely that the insufficiency can also be quantified without further enquiry and a discovery assessment raised.

For this purpose, a related tax return is that of another party to the same transaction, rather than another transaction involving a similar or identical asset. The latter could include several parties disposing of a jointly owned asset or shareholders disposing of the shares in the same company at the same time in similar circumstances, usually the sale of a whole company.

The return of capital gains requires an entry to indicate that a valuation has been used and asks for a copy of any valuation received. If these provide the information mentioned above the taxpayer can rely on protection from later discovery assessment.

Other Judgmental Issues

There are many items such as reserves, provisions and stock valuation that are routinely included in accounts as well as some exceptional items such as capital/revenue expenditure in repairs that require an element of judgement on the part of the taxpayer or representative. It has been customary to provide details of such items in the accounts or computations and many taxpayers have continued to do so.

It is difficult to see how an inspector might come to the conclusion that an assessment is insufficient because of one of these items without making any enquiry. There will be instances in which it becomes clear from an in-year enquiry that previous years figures were incorrect. The decision in the Veltema case does not alter that situation.

It may be possible to gain finality with the more exceptional items. An example might be a deduction in the accounts under Repairs. If an entry in the Additional Information space points out that a programme of work has been carried out that included repairs, improvements and new building work and that the total cost has been allocated to revenue and capital on a particular basis, the inspector should not enquire after the closure of the enquiry period unless he becomes aware that the statement was patently untrue or the basis of allocation was so unreasonable as to be negligent.

Taking a Different View

It is open to a taxpayer properly advised to adopt a different view of the law from that published as the Revenue's view. To protect against a discovery assessment after the enquiry period the Return would have to indicate that a different view had been adopted. This might be done by entering in the Additional Information space comments to the effect that they have not followed Revenue guidance on the issue or that no adjustment has been made to take account of it.This would offer an opportunity to the Revenue to take up the return for enquiry. In the Revenue's view it is not necessary for the taxpayer to provide with the Return enough information for the inspector to be able to quantify any resulting under assessment of tax.

A current example of this is the Revenue's guidance on Settlements Legislation in S660A. The guidance on discovery is that taxpayers should enter in the Additional Information space comments to the effect that they have not followed the Revenue guidance in respect of S660A. As indicated above, protection can be achieved by noting that "Revenue guidance indicates that S660A may apply. No adjustment has been made.".

The Veltema judgment does not require the provision of enough information to quantify the effect on the self assessment.

Provided the point at issue is clearly identified and the stance adopted is not wholly unreasonable, the existence of an under-assessment or insufficiency is demonstrated by the statement that a different view of the law was followed. It is not necessary to provide all the documentation that the inspector might need to quantify that insufficiency if he chose to enquire into the Return. In these circumstances the taxpayer achieves finality if no enquiry is opened within the twelve month time limit.