

SP 01/06 - Self Assessment: Finality and Discovery

Overview

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 does not provide enough information for the inspector to realise, within the enquiry period, that the self assessment is insufficient.

The judgement of the Court of Appeal the case of *Langham v Veltema* 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 Statement of Practice clarifies the circumstances in which HMRC seeks to recover tax when a self assessment is found to be insufficient either:

after the end of the period in which a notice of enquiry may be given, or
after an enquiry into a return has been completed.

and it is considered that the information provided by the taxpayer was not sufficient to make the Inspector aware of the insufficiency. The following examples illustrate what information taxpayers must disclose to guard against the possibility of a subsequent discovery assessment:

Most taxpayers who use a valuation in completing their tax return and 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.

Most taxpayers will be able to gain finality with exceptional items in accounts. 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 unreasonable.

Taxpayers who adopt a different view of the law from that published as the Revenue's view can protect against a discovery assessment after the enquiry period. The Return would have to indicate that a different view had been adopted 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 Statement does not cover cases where a self assessment is insufficient due to fraudulent or negligent conduct by or on behalf of the taxpayer.

This Statement applies to the two main areas of self assessment:

Income Tax and Capital Gains Tax ("IT")

Corporation Tax ("CT")

This statement of practice applies to the following for the years specified:

Individuals – for returns from 1996/97

Partnerships – for returns from 1996/97

For bodies within the charge to Corporation Tax – accounting periods ending on or after 1 July 1999

Background

1. Prior to the introduction of self assessment, discovery assessments were subject to statute, case law and practice. Cases of particular relevance were *Cenlon Finance Co Ltd v Ellwood* (40 TC 176) and *Scorer v Olin Energy Systems Ltd* (58 TC 592). Statement of Practice 8/91 explained how the provisions were applied.

2. When IT self assessment (“ITSA”) was introduced by FA 1994, new S29 TMA 1970 was intended to reproduce the mix of law and practice on discovery set out in SP 8/91. The Self Assessment Legal Framework issued in 1995 explained that the redrafting of S29 TMA 1970 was to ensure

“that a taxpayer who has made a full disclosure in the return has absolute finality twelve months after the filing date. This will be the case if the return is subsequently found to be incorrect, unless it was incorrect because of fraudulent or negligent conduct. In any case where there was incomplete disclosure or fraudulent or negligent conduct the Revenue will still have the power to remedy any loss of tax”.

The intention was to offer finality, but there was also a recognition that there would be circumstances, even without fraud or neglect, that could still result in a discovery assessment. The equivalent legislation for CT self assessment (“CTSA”) is at Paras 41 to 49 Sch 18 FA 1998.

3. The Court of Appeal in the case of *Langham v Veltema*, [2004] STC 544, considered when disclosure was incomplete. It concluded that information made available, as defined in statute, must make an Inspector aware of an actual insufficiency in the assessment for that information to be complete enough to prevent the making of a discovery assessment. That conclusion gave rise to two concerns:

the lack of finality for the taxpayer at the close of the enquiry window; and

the inherent difficulty of complying with the law as expounded in the Court of Appeal.

4. Guidance was issued in December 2004 to help ITSA taxpayers achieve finality when completing their 2004 returns. This Statement of Practice confirms the position in respect of ITSA and extends it to CTSA. The circumstances in which HMRC will regard a taxpayer as having made a full disclosure are set out and assurance of finality is given in particular situations.

Discovery Powers

5. The authority to make a discovery assessment is given by S29 TMA 1970 (ITSA), Para 41 Sch 19 FA 1998 (CTSA). In all cases, the relevant requirement for the purposes of this Statement is a discovery “that an assessment to tax is or has become insufficient”. Mere suspicion that an assessment may be insufficient is not adequate grounds for making a discovery assessment.

6. Where there has not been fraudulent or negligent conduct, discovery can only take place where HMRC “could not have been reasonably expected, on the basis of information made available before that time, to be aware of” the insufficiency in the assessment [S29 (5) TMA 1970; Para 44(1) Sch 18 FA 1998].

7. ‘Information made available’ is defined at S29 (6) TMA 1970 (ITSA), Para 44(2) Sch 18 FA 1998 (CTSA). Relevant information includes that contained in documents accompanying the return.

8. The requirement that HMRC must discover that an assessment is insufficient restricts the opportunity for using discovery powers to make an assessment. If HMRC considers that an assessment may be insufficient, it may seek more information using S20 TMA 1970 to establish whether the assessment is insufficient. However, where there is no reason to suspect fraud, the taxpayer will be told about the use of Section 20 and will have the opportunity to make representations to an independent Commissioner. The ability of HMRC to “enquire” after the closure of the enquiry window is therefore subject to external oversight.

Discovery in Practice

9. A taxpayer can further restrict the opportunity for discovery by providing enough information for an HMRC officer to realise within the enquiry period that the self assessment is insufficient. However taxpayers are encouraged to submit the minimum necessary to make disclosure of an insufficiency. The Veltema judgement does not require the provision of enough information to quantify the effect on the assessment. Information will not be treated as being made available where the total amount supplied is so extensive that an officer ‘could not have been reasonably expected to be aware’ of the significance of particular information and the officer's attention has not been drawn to it by the taxpayer or taxpayer's representative.

10. HMRC recognises that a taxpayer, unless acting fraudulently or negligently, will consider his return to be correct and complete with no insufficiency. Most figures entered on a return will be absolute, however some will be open to interpretation or uncertain. In these circumstances, the taxpayer will have made a judgement as to the correct figure to enter. HMRC may regard this figure as insufficient. Where the taxpayer has fully alerted HMRC to the full circumstances of such an entry on the return, then the HMRC officer is in a position to determine whether or not there is an insufficiency, the conditions set by the Court of Appeal in Langham v Veltema have been met and the assessment will not be open to discovery on that point.

The following examples illustrate common situations.

Examples of Common Situations

Valuation Cases

11. Some entries on tax returns depend on the valuation of an asset. For example, if a company transfers a property to a director at less than market value, both the company and the director will need to use the market value in calculating the capital gain and benefit respectively. There is no obligation on the director to do any more than enter the resulting benefit in the relevant box on his return. However, the Court of Appeal decided in

Langham v Veltema that the figure on the return does not give HMRC the level of information that is necessary to prevent a later discovery assessment.

12. Most taxpayers who state 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.

13. The main exception will be where, as in the example of a property transferred to a director, the same transaction is the subject of an agreed valuation in a related tax return, that of the company. It may then come to light that the director's return was insufficient and a discovery assessment raised. It is also likely that the insufficiency can be quantified without further enquiry. 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 returns of several parties disposing of a jointly owned asset or shareholders disposing of all the shares in the same company in a single transaction, for example, may be related for this purpose.

Where taxpayers' interests in an asset or assets are similar, but not the same, any valuations agreed would not necessarily bind other taxpayers.

14. Information about the valuation may be provided in the Additional Information space (ITSA) or in accompanying documents (ITSA and CTSA). The return of capital gains for ITSA purposes 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 a later discovery assessment.

Other Judgemental Issues

15. 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, which require an element of judgement on the part of the taxpayer or representative. Prior to the introduction of self assessment it was customary to provide details of such items in the accounts or computations and many taxpayers have continued to do so.

16. It is difficult to see how HMRC might come to the conclusion that an assessment is insufficient because of one of these items without making an 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.

17. 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 or accompanying documentation 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 HMRC officer will not use discovery powers 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

18. It is open to a taxpayer properly informed or advised to adopt a different view of the law from that published as HMRC's view. To protect against a discovery assessment after the enquiry period, the return or accompanying documents would have to indicate that a different view had been adopted. This might be done by comments to the effect that the taxpayer has not followed HMRC guidance on the issue or that no adjustment has been made to take account of it. This would offer an opportunity to HMRC to take up the return for enquiry. It is not necessary to provide all the documentation that HMRC might need to quantify that insufficiency if an enquiry into the Return is made.

19. 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 has been followed. In these circumstances the taxpayer achieves finality if no enquiry is opened within the statutory time limit.