TRAVERS SMITH

Tax Investigations Update

February 2021

Introduction

Since our previous briefing there have been a number of developments in the area of tax investigations and disputes. This briefing summarises some key ones and what they mean for taxpayers.

The themes set out in our previous briefing continue to dominate: HMRC's statutory powers and information rights, and the limitations on them. Proposals for new powers in the form of 'Financial Institution Notices' look set to go ahead despite having been the subject of unfavourable scrutiny from the House of Lords, whilst the Office of Tax Simplification is taking a fresh look at how HMRC uses third party data. Meanwhile, judgement has been handed down in important cases considering litigation privilege in the context of tax advice and key procedural limitations on HMRC's powers to conduct enquiries (being the concept of 'staleness' and the taxpayer's ability to apply for a 'partial closure notice').

How we can help

As one of the largest teams of tax lawyers in the City, we have extensive knowledge advising on disputes with tax authorities and early stage enquiries. With the vast majority of HMRC enquiries or investigations concluded well before litigation, our focus is seeking swift and decisive resolutions, whilst protecting our clients' commercial interests.

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Development	Summary	Why does it matter?
Financial Institution Notices – set to go ahead despite House of Lords criticism	In July, the government published draft rules for the introduction of a new form of notice – a financial institution notice ("**FIN**") which would make it easier for HMRC to require financial institutions (including banks and fund managers) to provide them with information about their clients, as HMRC would no longer be required to get the approval of the taxpayer who is the subject of the information request or the tax tribunal. In December, the House of Lords Economic Affairs Finance Bill Sub-Committee ("the **Committee**") produced a report (the "**Report**") which strongly criticised the proposals and set out a number of recommendations. These included that (i) the requirement for tribunal approval for a third party information request to a financial institution should remain, (ii) financial institutions should have a right of appeal against requests they consider unduly onerous and (iii) HMRC reconsider the implementation date. However, within the last week, the government has published a response to the Report which, in essence, rejects all the Committee's recommendations. It therefore appears likely that the FIN proposals will be implemented substantially in their current form.	Taxpayers will be disappointed that the government has not taken on board the Committee's criticisms of the FIN proposals. This is especially the case given the forthright manner in which the Committee felt it necessary to put its views: *"[T]he civil information powers proposals are poorly targeted, disproportionate in their effect on UK taxpayers and lacking necessary safeguards and rights of appeal. They remove safeguards for taxpayers and financial institutions which prevent arbitrary use of the information powers, and are not supported by the evidence."* If, as seems likely, the proposed new rules are enacted substantially in their current form, it is, in our view, far from clear that taxpayers and financial institutions would have an effective means of disputing a FIN. Given the ever more assertive manner in which HMRC is pursuing enquiries, a regime that allows it, to a significant extent, to police itself is potentially a real concern. Please click here for a previous briefing where we discussed the current FIN proposals in more detail.
Office of Tax Simplification (OTS) review: HMRC's use of third party data	The OTS has launched a call for evidence as part of its review into the use of third party data by HMRC. The review considers an opportunity to modernise tax administration by making smarter use of data on taxpayers, including from third parties. The information could be used to pre-populate an individual's tax return or be included within their online account with HMRC. As well as considering data already held by HMRC, and data that could be provided to it by other government departments, the OTS will look at HMRC obtaining information from a variety of third parties. The review covers an alternative way for HMRC to get information it already receives (rather than new types of information) and focuses on personal tax data relating to individuals. Possible sources of third party data being considered include pension contributions, gift aid payments to charities, dividends from UK companies and data from investment and wealth managers. The OTS gives as an example of something that it will consider, instead of individuals having to provide HMRC with details of potentially taxable income and gains on their investments, the uploading of the information by their investment or wealth management company and it being reflected in their online tax account or self-assessment return.	Any proposals which result from the OTS review have the potential to significantly improve taxpayers' interactions with HMRC, in particular the preparation and filing of their self-assessment returns. In some cases, the OTS envisage that the improved use of third party data could ensure that reliefs which would otherwise go unclaimed (for example, on charitable donations) are fully utilised. There will, however, need to be robust safeguards governing how HMRC makes use of large amounts of data which has been directly linked to a taxpayer's return for the first time, in particular in the context of investigations and enquiries. This includes the need for a mechanism for taxpayers to challenge data provided by the third party which they believe to be inaccurate (a point expressly acknowledged in the call for evidence) and clear principles governing how HMRC is able to use an individual taxpayer's data as part of wider investigations.

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'Discovery assessments' – developments in the concept of 'staleness'	A 'discovery assessment' is a powerful tool in HMRC's armoury, allowing it to recover tax for matters where the normal time limits for opening an enquiry have elapsed. Therefore, the question of whether the conditions for it to be issued have been met is often a key one in a dispute. A longstanding battleground here has been the concept of 'Staleness'. This has two aspects, is there actually a requirement that a discovery (of underpaid tax) not be stale and, if so, has it been met? Staleness is the concept that discovery can become invalid if HMRC fails to issue an assessment whilst the discovery is new. It is not expressly set out in legislation (as it derives from the courts' interpretation of the word 'discover' in statute), leading HMRC to take the view that it does not exist. Whether that is right will, hopefully, be resolved in a few weeks' time when the Supreme Court hears HMRC's appeal against the Court of Appeal decision in *HMRC v Raymond Tooth*. In this regard, recent First Tier Tribunal ("**FTT**") decisions do not augur well for taxpayers. The FTT in *Marano v HMRC* said that the case law has *"taken a wrong turning, introducing a new restriction which is not present in the statute"* and also in *Cumming-Bruce v HMRC* expressed doubt as to the validity of the concept. Indeed, even if *Tooth* confirms the existence of staleness, recent FTT decisions indicate that it may be hard for taxpayers to convince courts that a discovery has gone stale. In particular, in *Armstrong and Haire Ltd v HMRC* the FTT stated that the concept of staleness is intended to protect a taxpayer where a discovery is made and HMRC *"sit on it and do nothing for a number of years"* (as established in previous cases) and that it would *"only be in the most exceptional circumstances"* that a discovery would become stale.	Whilst the concept is far from fully settled in the courts, there is a body of case law which lends significant weight and authority to staleness. Thus, taxpayers may rightly look to raise it where HMRC have sat on a discovery for a number of years without making an assessment. We look forward to the Supreme Court's decision in *Tooth* – this will be an opportunity to settle the authority of staleness. Taxpayers will hope that it provides certainty that they are protected against inaction by HMRC investigating their affairs. Nevertheless, recent case law discussing this topic has demonstrated both a scepticism surrounding the concept, and the reluctance of the courts to invalidate discovery assessments on the basis of staleness other than in exceptional circumstances. In particular, if HMRC are actively working on a case and continuing to gather relevant information and analyse the facts, this is likely to undermine any staleness argument brought by the taxpayer. Regardless of the outcome of *Tooth*, which may affirm the conceptual basis of staleness, the reluctance of the courts to apply it other than in exceptional circumstances is likely to continue.

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Financial Reporting Counsel (FRC) v Frasers Group plc (formerly Sport Direct International plc) (SDI) - litigation privilege	The case of the FRC v SDI considered whether litigation privilege applied to three reports provided by accountants to a subsidiary of SDI ("**SDR**"). The accountants had been instructed to advise on the implementation of certain changes in SDR's VAT planning as SDR were aware that structures similar to their own arrangements were being scrutinised and challenged by other tax authorities. The first report set out the accountants' recommendation to adopt a new structure for the purposes of the VAT planning and the second and third reports held explanations of how the VAT was to be accounted for under it. The High Court considered the requirements for litigation privilege to apply and focused on the need for the relevant communication to have been made for the sole or dominant purpose of obtaining legal advice about, or evidence or information for, litigation. It, essentially, ruled that litigation privilege did not apply, as the documents reacted to a perceived threat of litigation by amending the VAT structure, rather than being created for the sole or dominant purpose of litigation. This was despite the fact that the accountants had been instructed to advise in preparing to respond to, defend and/or avoid anticipated litigation with a tax authority in respect of the VAT planning.	The case serves as a reminder that, where a taxpayer is taking advice to implement tax planning or on structuring its tax affairs, that taxpayer does not do so for litigation purposes, but does so (in the words of Lord Justice Nugee in the judgement) *"because he wants to achieve a particular result for tax purposes"*. This is the case even if it is contemplated that the planning or structure in question may later be challenged by the relevant tax authorities. It is particularly noteworthy here that if the taxpayer had instructed legal advisers to provide advice and produce the structure papers in question (rather than accountants as in the facts of the case), then the taxpayer could have relied on legal advice privilege, such that the reports would not have been required to be disclosed to a tax authority in a subsequent enquiry or challenge. For more detail on the case please click here.
HMRC v Embiricos – partial closure notices	In the recent Upper Tribunal ("**UT**") case of *Embiricos*, the taxpayer, Mr Embiricos, was involved in a dispute with HMRC about whether he had been UK domiciled in two tax years where he had claimed the remittance basis. HMRC (who believed that Mr Embiricos was UK domiciled and therefore not entitled to claim the remittance basis) had requested details on the amount of Mr Embiricos' unremitted foreign income and gains. Mr Embiricos wanted the issue of his domicile to be resolved before providing this information (which would be irrelevant if he was successful on the domicile issue). He therefore applied to the tribunal for a direction that HMRC issue a 'partial closure notice' ("**PCN**") in relation to the domicile issue, which he could then dispute. However, the UT, overturning the decision of the FTT, found that HMRC could not be required to issue a PCN in these circumstances.	This decision resolves the conflict which had previously existed between the FTT's decision in *Embiricos* and *Levy* (another FTT decision which reached the opposite conclusion). Whilst the clarity is welcome, the decision will be disappointing to those taxpayers involved in domicile enquries (as they will have to spend time providing HMRC with details of their income and gains even if they ultimately are determined not to have been UK domiciled) and to taxpayers more widely. This is because it limits the circumstances in which PCNs will be of use in resolving preliminary or side issues as part of a wider enquiry. As the UT pointed out, a separate mechanism exists under which preliminary issues in an enquiry may be referred to the tribunal for resolution, but this procedure requires a joint application from both the taxpayer and HMRC. We understand that Mr Embiricos has been granted permission to appeal to the Court of Appeal.