Comment

Discovery assessments: only as careful as your advisors

Michael Collins, Barrister, Temple Tax Chambers

Since the 2010 changes to the time limits for discovery assessments, it is more common to see HMRC relying on carelessness 'by the taxpayer or a person acting on his behalf' as a ground of discovery (TMA 1970 s 29(4)). The changes to the time limits reduced the limit where the ground of discovery was lack of information to four years, whereas the limit for discovery on the basis that an error was brought about carelessly or deliberately is six years (TMA 1970 ss 34, 36).

It is important to remember that the six year limit applies whether the conduct in question is that of the taxpayer or 'a person acting on his behalf'. So while a taxpayer may have acted with reasonable care in having his tax returns prepared by a tax advisor, this will not protect him from a discovery assessment if the tax advisor did not take reasonable care.

Leslie Smith v HMRC

A recent example is the decision of the Upper Tribunal in *Leslie Smith v HMRC* [2011] UKUT 270 (TCC). The taxpayer had retained accountants to prepare his annual accounts and tax returns. Unfortunately for the taxpayer his accountants did not follow generally accepted accounting practice (GAAP) on the question of when income should be recognised in respect of certain contracts entered into by the taxpayer. The result was that some payments fell into later tax years than would have been the case if GAAP had been followed. The case was decided on the pre-2010 legislation before carelessness replaced negligence as the statutory requirement. HMRC issued a discovery assessment on the grounds that the taxpayer's accountants were negligent.

In the First-tier Tribunal ([2010] UKFTT 92 (TC)) Judge Hellier, after a careful examination of the accounting evidence, held that the accountants had been negligent in failing to follow GAAP and dismissed the appeal. Against that background it is a credit to counsel for the taxpayer's powers of persuasion that permission was granted to appeal to the Upper Tribunal. The taxpayer's argument in the Upper Tribunal based on *Edwards v Bairstow* was rejected: unsurprisingly given the careful consideration of the evidence by Judge Hellier. Further arguments on the jurisdiction of the Tribunals were also rejected. The main remaining argument of the taxpayer was that the First-tier Tribunal had applied the wrong test in determining whether the accountants were negligent.
It was accepted that the test of negligence or carelessness was whether the accountants had taken reasonable care. The standard applied by the First-tier Tribunal was that of a normally competent accountant and tax advisor. However, the taxpayer argued that the relevant standard ought to have been that of the reasonable lay person. The Upper Tribunal rejected the taxpayer's arguments.

Is the view tenable?

In *Leslie Smith* it was clear that by failing to follow GAAP the accountants had failed to take reasonable care in preparing the taxpayer's returns. In other cases the question may be more difficult, especially where there is one than one view of the correct application of the legislation in question. In such cases the fact that the advice turns out to be wrong does not necessarily mean it was careless provided the view taken by the advisor was a tenable one. The fact that HMRC may have published their view on the question from which the agent differs is immaterial: there is no obligation to give HMRC the benefit of the doubt provided the view taken by the advisor is tenable.

Who is acting on the taxpayer's behalf?

In *Leslie Smith* it was clear that the accountants who prepared the taxpayer's return were persons 'acting on his behalf'. However, in *Trustees of the Bessie Taube Discretionary Settlement Trust v HMRC* [2011] SFTD 153, HMRC sought to apply include within those words persons other than the taxpayer's advisors. The case concerned the question of whether a special dividend paid by a company to a trust was an income or capital receipt in the hands of the trustees. The First-tier Tribunal held that the dividend was income to which the taxpayer became entitled as a life tenant of the trust. HMRC argued that they were entitled to make a discovery assessment on the basis of lack of information disclosed in the taxpayer's return and the First-tier Tribunal agreed. In the alternative HMRC argued that they were entitled to make a discovery assessment on the basis that the error in the return has been brought about carelessly by a person acting on behalf of the taxpayer. The person HMRC argued had been careless was neither the taxpayer nor any of his tax agents but the trust's solicitors who had advised the trustees that the dividend was a capital receipt. The Tribunal rejected HMRC's arguments and held that the legal advisors to the trust were not 'acting on behalf of the taxpayer'. On the meaning of those words the Tribunal said the following (at para 93): *'the expression 'person acting on ... behalf' is not apt to describe a mere advisor who only provides advice to the taxpayer or to someone who is acting on the taxpayer's behalf. In our judgment the expression connotes a person who takes steps that the taxpayer himself could take, or would otherwise be responsible for taking.'*

The Tribunal gave as examples completing and filing a return and entering into correspondence with HMRC.

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Jennie Rimmer, Head of Tax, Lockton Ltd

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