An inspector calls

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Keith Gordon discusses a recent challenge by way of judicial review to an HMRC investigation

Key Points

What is the issue?

Most of the statutory rules governing HMRC's powers to look at a taxpayer's records can be found in Schedule 36 to the Finance Act 2008. At the heart of those rules is the fundamental requirement that any information requested be 'reasonably required' for the purposes of checking the taxpayer's tax position. However, a restriction on HMRC's powers as found in para 21 is often overlooked.

What can I take away?

If taxpayers fail to comply with an informal request for information, HMRC are likely to resort to their formal powers. The taxpayer can then ensure that the reasonableness of HMRC's requests will be able to come before a judge.

What does it mean to me?

Many advisers will have cases where they consider that investigations are taking too long. Challenge any Schedule 36 notice if the documents or information sought are not reasonably required.

It is inevitable that there will be occasions when HMRC will want to look at a taxpayer's records or those held by a third party.

Most of the statutory rules governing HMRC's powers in relation to such checks were consolidated as part of the 'powers review', which followed the creation of HMRC and can be found in Schedule 36 to the Finance Act 2008. These permit HMRC to seek documents or information by a request known as an 'information notice'.

At the heart of those rules is the fundamental requirement that any document or information requested be 'reasonably required' for the purposes of checking the taxpayer's tax position, a phrase that has been examined by the tribunal and higher courts over the past decade.

However, often overlooked is a restriction on HMRC's powers as found in para 21 of that Schedule. Paragraph 21 applies, however, only in cases where the taxpayer has submitted a tax return (which is presumably a reference to a tax return for the period under investigation, rather than a tax return for some wholly irrelevant period).

In my experience, HMRC officers will readily cite the 'reasonably required' rule but usually fail (unless asked) to address para 21.

In cases where a return has indeed been made, the legislation starts by providing that HMRC may not issue an information notice. That is of course a rather limiting provision, given that it would seem to preclude HMRC from doing what they most frequently do (which is to check the paperwork underlying a taxpayer's return).

However, that restriction is then subject to four exceptions (known as Conditions A to D).

Conditions to issuing an information notice

Condition A is satisfied if there is an open enquiry into the return. Clearly, Condition A avoids the obvious problem that would otherwise arise from the general rule under para 21.

Readers will, however, be aware that there are occasions when HMRC are too late to open an enquiry into a tax return but still wish to investigate the correctness of the tax return with the possibility of issuing a discovery assessment at a future date. In such cases, Condition B will usually be relevant and that is satisfied when HMRC have reason to suspect an under-assessment. As was made clear by the First-tier Tribunal (FTT) in Betts [2013] UKFTT 430, this condition is (as it says) a provision that prevents HMRC from merely checking a tax return for possible errors – being interested in the tax return is not enough. HMRC must already have a basis for believing the tax return to be materially incorrect.

Conditions C and D deal with situations where HMRC are looking at the taxpayer's PAYE or (typically) VAT position, these being matters that are not governed by the statutory 12 month enquiry window.

Usually, it is unnecessary for HMRC to resort to these powers in Schedule 36 because taxpayers generally comply with informal information requests. Indeed, when advising taxpayers, I start from the position that there is no point objecting to a request for information which HMRC could legitimately ask for under Schedule 36. Where, however, the request goes beyond what Schedule 36 permits (and failure to abide by the restrictions in para 21 is a frequent shortcoming), I have no compunction in ensuring that the taxpayer is fully aware of the rights of challenge against HMRC's request. Indeed, as the FTT recently held in *Perfectos Printing Inks Co Ltd* [2019] UKFTT 0388 (TC), there is nothing inappropriate about 'a well advised taxpayer insisting on its strict legal rights'.

The use of information notices under Schedule 36 is subject to the supervision of the FTT. Ordinarily, this supervision is conferred by the taxpayer's right of appeal against an information notice. However, there will be occasions when HMRC want to issue a notice to the taxpayer in situations where the taxpayer may not appeal

against the notice. However, for this to happen, HMRC must obtain the tribunal's prior approval. The relationship between these two approaches is beyond the scope of this article.

As I have already indicated, HMRC do not always need to resort to issuing formal notices under Schedule 36 because taxpayers often comply with informal requests. However, such informal requests are not (in the main) covered by the legislation and, accordingly, their legal status was always the subject of some inherent uncertainty. Some of that uncertainty has been addressed by the High Court's recent decision in *R (oao JJ Management LLP and others) v HMRC and FTT (Tax Chamber)* [2019] EWHC 2006 (Admin).

The facts of the case

Since about 2016, HMRC have been investigating the tax affairs of a Mr Bryn Robinson and various corporate entities with which he is associated. Those investigations have included making requests to the tax authorities in Spain and Portugal where much of the taxpayer's business activities take place. Mr Robinson, however, is UK resident and domiciled.

Nor are there any equivalent enquiries into any of the tax returns filed by the UK corporate entities subject to HMRC's investigation.

Mr Robinson wished to challenge the investigation. However, as HMRC are currently operating outside the scope of Schedule 36, i.e. informally, Mr Robinson is unable to turn to the FTT. Accordingly, he has had to mount a judicial review challenge in the High Court.

Although the FTT is a party to the judicial review claim, that relates to grounds that have been stayed for a later hearing.

The questions before the court

Mr Robinson's grounds of challenge were as follows.

First, he argued that the underlying investigation is *ultra vires* in that, in the absence of an open enquiry or any other action in accordance with Schedule 36, HMRC's actions are entirely without any legal basis.

Secondly, by acting outside the scope of Schedule 36 and beyond the supervision of the tribunal, Mr Robinson argued that HMRC are denying him access to justice.

Allied to this, Mr Robinson sought the exercise of the court's supervisory jurisdiction over HMRC's 'irrational and disproportionate decision' to investigate all of his tax affairs.

Finally, Mr Robinson argued that the requests made to the Spanish and Portuguese authorities are unlawful.

The court's decision

The case came before Mr Justice Nugee, who dismissed Mr Robinson's claims on all grounds.

In respect of the first, the judge accepted the proposition that, as a statutory body, HMRC may act only in accordance with its statutory powers. Whilst that might initially suggest that acting outside the scope of Schedule 36 would be unlawful, the judge accepted that carrying out an 'informal investigation' is authorised by the Commissioners for Revenue and Customs Act (CRCA) 2005 ss 5 and 9 and the Taxes Management Act 1970 s 1. Ultimately, they permit HMRC to 'do anything which they think necessary or expedient in connection with the exercise of their functions, or incidental or conducive to the exercise of their functions'. Nugee J considered that investigating 'whether a return is accurate and comprehensive or not ... seems ... a paradigm case of something which is necessary, expedient, incidental or conducive to the exercise of their function of collecting the right amount of tax'.

On Mr Robinson's behalf, it was submitted that the general powers conferred by CRCA 2005 were insufficient given the prescriptive statutory code found in Schedule 36. However, the judge was not convinced. In a case where a valid enquiry is open, Mr Robinson appears to have accepted that information requests may be made outside the formal regime established under Schedule 36. However, as in this case there were no such enquiries, Mr Robinson argued that HMRC should resort straight to the formal processes laid out in Schedule 36 so that the process is ultimately under the tribunal's supervision. Again, however, the judge was not persuaded. He noted that the undesirable consequence of that argument was that a taxpayer could receive 'out of the blue a formal demand from HMRC for information and documents, backed by penal sanction, and unheralded by any previous attempt to obtain the

information voluntarily’.

The judge considered that Mr Robinson’s second argument was largely dealt with by his response to the first. However, he added that a taxpayer who felt that an investigation was drifting, and where HMRC had not resorted to the use of their formal powers, was not without a legal remedy. In particular, an unreasonable delay could itself be the subject of judicial review.

In respect of the request that the court exercise a supervisory jurisdiction over the conduct of the investigation, the judge disagreed with one aspect of HMRC’s submissions and accepted that this was theoretically possible. However, he agreed with HMRC that this should occur only in wholly exceptional cases where there was ‘evidence of fraud, corruption or mala fides’. As a result, he did not consider it necessary to establish whether HMRC’s enquiry was for a legitimate purpose. However, the judge looked at this point as well and concluded that the correspondence demonstrated that Mr Robinson and his advisers knew ‘the gist of HMRC’s concerns’ and were therefore not ‘entitled to further explanation of the basis of their concerns’.

For completeness, the judge also considered that the requests made to the Spanish and Portuguese authorities are similarly lawful.

Commentary

Although I do not consider there to be much that is controversial with the decision, it is certainly helpful for other taxpayers to have these principles so clearly set out. Indeed, there are some aspects of the judgment which other taxpayers might wish to cite in appropriate cases.

For example, the judge acknowledged HMRC’s current normal practice of seeking informal compliance with an information request before they issue a formal information notice. As HMRC’s guidance (cited by the judge) makes clear, a formal notice should not normally be issued ‘unless the taxpayer has refused to co-operate with an informal request’. The judge considered that this represented ‘an entirely proper approach for HMRC to take’. Some readers will know that occasionally officers are trigger-happy and issue formal notices without any prior informal request. As the guidance makes clear, the practice endorsed by the judge is caveated with the word ‘normally’. However, the judge’s endorsement reinforces the

appropriateness of the ‘normal’ practice, and where HMRC deviate from that they should do so only in circumstances where they can justify their decision to jump straight into the statutory process.

HMRC justified their practice of acting informally ‘as this promotes co-operation, collaboration and often progresses a tax investigation expeditiously’. I have no quarrel with the principle here but I would add a note of caution. It is often the case that these informal requests go beyond what HMRC could legitimately ask for in a formal notice under Schedule 36. I have often seen requests cut back when an informal request is then repackaged into a formal notice, solely because HMRC know that some of their original requests would not stand up to scrutiny before a tribunal.

Indeed, I have heard ex-HMRC investigators (now working for the private sector) acknowledge that it was common practice to ask for whatever they thought they might get, rather than what they believed that they were entitled to. In my view, this raises some interesting questions of ethics. As a member of the general body of taxpayers, I can certainly see the benefits of HMRC getting information freely so as to ensure that the correct amount of tax is being paid by everyone else. But it does worry me that HMRC officers are given a free rein to try it on, in the hope that a taxpayer (or adviser) won’t notice. By analogy, is there any difference between that conduct and that of a taxpayer who (say) claims as an allowable expense something that he or she does not really believe to be allowable, in the hope that the matter will fly beneath the radar?

I would say that HMRC should generally limit themselves to requests for what they believe they are entitled to (and where they would be willing to stand by their demands in a tribunal if necessary). However, I would not mind HMRC asking for more, provided that they made it clear that these additional requests were truly voluntary and that a taxpayer’s decision not to comply would have no adverse consequences (for example, if co-operation is taken into account when calculating penalties at a later date).

One possibly surprising matter about the case is that HMRC could have opened but did not open a statutory enquiry. In my view, such a precaution could have avoided this entire judicial review from being commenced. The absence of an enquiry was explained by HMRC’s counsel as ‘understandable’ where, in a case such as this, ‘HMRC wish to conduct a wide range investigation’. The court also noted that this

represented the standard practice for the team conducting the investigation into Mr Robinson’s tax affairs.

However, again speaking from the perspective of a member of the general taxpaying public, I do wonder whether HMRC ought to open statutory enquiries in such cases for those years where the enquiry window is still open. At the very least, such an approach will be able to ensure that HMRC are not then subject to the additional restrictions which limit their right to make discovery assessments, meaning that there is less risk of any underpaid tax escaping assessment. About the only downside to such an approach would be that HMRC would have to justify keeping their enquiries open if the taxpayer makes an application for a closure notice. This ought not to be an onerous imposition on HMRC, though, as the closure notice application process is merely a safeguard for taxpayers designed to ensure that enquiries do not become too prolonged.

What to do next

Many advisers will have cases where they (or their clients) consider that investigations are taking too long. For those cases covered by an enquiry notice, the remedy is straightforward: seek a closure notice via the tribunal. In other cases, challenge any Schedule 36 notice that is given if the documents or information sought are not reasonably required. Mr Robinson’s case highlights the difficulties that will be faced when HMRC continue to act without using any of their formal powers. However, the judge made the observation as to what taxpayers should consider doing in such cases: if they fail to comply with an informal request for information, HMRC are likely to resort to their formal powers. Accordingly, the taxpayer ought to ensure that the reasonableness of HMRC’s requests will be able to come before a judge.

In the meantime, it is noted that the judge has recognised the importance of the issues discussed. He seems to have given permission to Mr Robinson to appeal against the decision. The Court of Appeal is therefore likely to hear this case by the end of 2020.