Partners in tax

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Keith Gordon looks at a case which considers the statutory processes governing the opening and closure of partnership enquiries

Key Points

What is the issue?

In the 2004/05 tax year, Mr Reid and Dr Emblin parti cipated in two separate arrangements which sought to generate losses for tax purposes. One set of arrangements was via membership of a loss-making partnership; the other was entered into by each of them on an individual basis.

What does it mean to me?

Enquiries into partnership tax returns are opened under s 12AC and closed under s 28B. Partnerships themselves do not pay tax; instead, the partners have to pay tax on their share of the partnership’s profi ts. As a result, a typical enquiry into a partnership’s tax return will deal with matt ers that impact on the partners themselves.

What can I take away?

The legislation gives the very strong impression that s 28B(4) noti ces are not closure notices. On that basis, it considered that HMRC was fully entitled to remove the non-partnership losses via s 28A closure notices. However, it went on to make some comments about anomalies arising from the legislation.

As I noted in my January 2020 article ‘What a carry-back!’, there remain a number of unresolved questions concerning the operation of the Self Assessment code, with one of the problem areas being enquiries into partnerships.

The background

Leaving aside the relatively new concept of partial closure notices, an enquiry into a tax return is usually quite straightforward. Focusing on individuals for the time being, enquiries may be opened by notice under the Taxes Management Act 1970 s 9A and, in due course, are closed by a further notice under s 28A. Under s 9A(3), a return that has been subject to one enquiry may not be subject to a further enquiry (except in certain cases where the original return has since been amended). As implicit from s 28A (and since confirmed by case law), an enquiry (once opened) remains open until such time as it is formally closed.

A similar set of provisions applies in relation to partnership tax returns. Enquiries are opened under s 12AC and closed under s 28B. However, it will be remembered that partnerships themselves do not pay tax; instead, the partners have to pay tax on their share of the partnership’s profits. As a result, a typical enquiry into a partnership’s tax return will deal with matters that impact on the partners themselves.

The legislation has addressed this point by determining that any notice commencing an enquiry into a partnership’s tax return is deemed to amount to an enquiry notice under s 9A to each partner ‘who at the time has made a return … or at any

subsequent time makes such a return' (s 12AC(6)).

Although not spelled out in the legislation, it is implicit that this 'deemed notice of enquiry' into a partner's own tax return can be given, even if it would ordinarily be too late for HMRC to enquire into the partner's own tax return. It is also implicit that the deemed notice of enquiry relates only to the tax return for the same tax year as covered by the partnership tax return under enquiry. However, even if those gaps in the legislation can be overcome by implication, some questions remain:

- What is the scope of the deemed enquiry?
- Does it cover the entirety of the partner's own tax return or just those aspects of the return that pertain to the partner's membership of the partnership?
- Given that there can be only one enquiry into an individual's return, what is the status of a deemed enquiry if the partner's own return has already been subject to an enquiry which has since been closed down?

The complexities are compounded when one considers the provision in s 28B(4) which requires HMRC, when amending a partnership tax return, to consequentially amend each partner's tax return and to give the partners notice of such amendments. Partners have no right of appeal against s 28B(4) notices, even though this is effectively a closure notice into the partnership aspects of the partners' own returns. Of course, the partnership can appeal against the closure notice given to the partnership.

Some of these issues came to the fore in the recent case of Reid & Emblin v HMRC [2020] UKUT 61 (TCC).

The facts of the case

In the 2004/05 tax year, Mr Reid and Dr Emblin participated in two separate arrangements which sought to generate losses for tax purposes. One set of arrangements was via membership of a loss-making partnership; the other was entered into by each of them on an individual basis.

The losses thought to have arisen from the various arrangements were then claimed by Mr Reid and Dr Emblin on their respective tax returns for the 2004/05 tax year. The partnership similarly filed a tax return for the 2004/05 tax year claiming the partnership's losses and allocating those losses to the various partners.

HMRC opened an enquiry into the partnership tax return on 7 September 2006. Although this notice also amounted to opening enquiries into the tax returns of each of the partners, including Mr Reid and Dr Emblin, HMRC proceeded to open enquiries into Mr Reid's and Dr Emblin's personal tax returns (on 25 September 2006 and 10 January 2007 respectively).

On 14 January 2013, HMRC issued a closure notice to the partnership under s 28B. This notice amended the partnership tax return by removing the aggregate losses previously claimed. In April 2014, HMRC wrote to each of the partners under s 28B(4) notifying them of the conclusions from the partnership enquiry and advising them of the consequential amendments to their own tax returns.

> At the heart of the tribunal's decision was its analysis of the statutory code which gave the strong impression that s 28B(4) notices are not closure notices.

Later in April 2014, HMRC wrote to both Mr Reid and Dr Emblin purporti ng to close down the enquiries into their personal tax returns, removing the losses claimed from the non-partnership arrangements.

Mr Reid and Dr Emblin consider that the late April 2014 noti ces are invalid closure noti ces. They believe that the enquiries into their personal tax returns had already been closed down, by the s 28B(4) noti ces they received earlier in the month. As a result, they argued, HMRC had lost the chance to remove the non-partnership losses from their tax returns.

HMRC's core argument was that a s 28B(4) notice does not amount to a closure notice. Instead, it provides a freestanding amendment to the partners' own returns, irrespective of the status of any actual s 9A enquiry into those returns. Furthermore, the deemed enquiry under s 12AC(6) is not an enquiry into the whole of a partner's tax return, but only into 'penumbral matters relating to a taxpayer's participation in the partnership whose corresponding partnership return is the subject of an enquiry'. Of course, nothing in s 12AC(6) states this explicitly.

The taxpayers appealed to the First-tier Tribunal which dismissed their appeals. The taxpayers duly appealed against the decision to the Upper Tribunal.

The tribunal's decision

The Upper Tribunal (Mr Justice Nugee and Judge Jonathan Richards) recognised that the legislation led to anomalies, but ultimately dismissed the taxpayers' appeals.

At the heart of the tribunal's decision was its analysis of the statutory code which gave the very strong impression that s 28B(4) notices are not closure noti ces. On that basis, the tribunal considered that HMRC was fully enti tled to remove the non-partnership losses via s 28A closure notices in late April 2014. Having reached this conclusion, however, the tribunal then made some comments about some of the anomalies arising from the legislation.

Although the tribunal considered that the legislation made it clear that individuals could not appeal against s 28B(4) noti ces (and, therefore, any challenge to HMRC's conclusions in relation to the partnership enquiry must be conducted at the partnership level), it recognised that this led to potential difficulties if the s 28B(4) notice contained minor errors not present on the partnership's own closure notice. Such errors, the tribunal recognised, could be challenged only by way of judicial review.

The Upper Tribunal also acknowledged that a deemed s 9A enquiry (i.e. one that has been opened because of s 12A(6)), once open, could then remain open indefinitely, although the tribunal concluded that such an anomaly could be rectified by the taxpayer seeking a closure notice under the procedure in s 28A(4).

Commentary

The tribunal's conclusion accords with my initial views as to the effect of the legislation. If one focused on HMRC's rights to open and close an enquiry into tax returns (whether from individuals or from partnerships), the Upper Tribunal's decision makes full sense. Furthermore, I have no problem with s 28B(4) providing no more than that consequential amendments to partners' own tax returns should be notified to the partners upon the closure of the partnership enquiry. (I am a little concerned, however, that HMRC frequently delays issuing such notices to the partners so that any decision by the partnership as to whether to challenge the partnership's closure notice will often be made without the partners being formally advised as to the impact of the closure notice on their personal tax liabilities. In the present case, there was a delay of almost 15 months. However, that is a separate point but something that might be worth addressing by the professional bodies in due course.)

Had the legislation stopped there, it would in my view be clear that s 28B(4) notices do not amount to closure notices. However, the deemed enquiry provision in s 12AC(6) casts a very different light on matters.

What is the point of s 12AC(6)? It cannot be to notify the partners of the existence of a partnership enquiry because the legislation does not actually require the partners to be told of the partnership enquiry. It must therefore be to deem there to be an open enquiry. However, if that is the case, there must be a way to close it. If the deemed enquiry extends to the whole return (as the wording of s 12AC(6) seems to suggest), then s 28A clearly achieves that objective. However, if that is the case, then s 28B(4) is of limited purpose (particularly now we have the concept of partial closure notices).

> It is unclear whether the case will proceed to the Court of Appeal, although some further clarity would be helpful.

Conversely, on HMRC's argument, where the deemed enquiry is more limited, then s 28B(4) is Parliament's equivalent to a closure notice in respect of that more limited enquiry, albeit without appeal rights. But, as I have said, this effect could have been achieved more neatly without s 12AC(6) being enacted.

I hope that this can be considered further, either by a further appeal to the Court of Appeal or by an overhaul of the legislation. If the latter, I wonder whether there would be any objections to the simple repeal of s 12AC(6).

Finally, it should be noted that the partnership at the centre of this case was in fact a limited liability partnership (LLP). Last year, the First-tier Tribunal held that enquiries into LLPs are not governed by the same rules as ordinary partnerships (Inverclyde Property Renovation LLP & Clackmannanshire Regeneration LLP v HMRC [2019] UKFTT 408 (TC)). HMRC's appeal against that decision is due to be heard by the Upper Tribunal later this month, as well as being addressed in the Finance Bill. The principles deriving from the Reid & Emblin case are nevertheless applicable to ordinary partnerships.

In the course of its decision, the Upper Tribunal also raised the question as to its jurisdiction. The taxpayers were arguing, on their appeal, that the late April 2014 closure notices were invalid. However, the tribunal was concerned that the logical conclusion of the taxpayers' argument was that the tribunal ought not to have any

jurisdiction to hear the appeal because its jurisdiction is dependent on there being a valid closure notice. In the end, the tribunal chose to gloss over this existential question and focused
on the fact that it was exercising its jurisdiction in an appeal from the First-tier Tribunal (where the point was not raised). In my view, however, there is nothing wrong with a tribunal considering whether or not it has jurisdiction and, as Dr John Avery Jones once held, a tribunal always has jurisdiction over such matters.

Furthermore, last year's Inverclyde decision addressed the point: by agreeing with the taxpayers in that case that the closure notice was invalid, it struck out the taxpayers' appeal. Although the strike out of an appeal is usually something that taxpayers do not want to happen, in cases such as this, it amounts to an acceptance by the tribunal that a closure notice is invalid which is the outcome that can be wanted by the taxpayers. Finally, it should be noted that the case also considered a challenge to accelerated payment notices received by Mr Reid and Dr Emblin. However, that part of the case is beyond the scope of this article.

What to do next

It is unclear whether the case will proceed to the Court of Appeal, although it would be helpful if some further clarity could be brought to this area. However, I believe that there are cases where HMRC considers the deemed enquiry under s 12AC(6) to extend to the entirety of a partner's personal tax return and not merely those matters penumbral to the partnership return. If HMRC's argument before the Upper Tribunal is correct, then HMRC may not use a deemed enquiry to look at wider aspects of the taxpayer's return.

It might also be appropriate for anyone who has been subject to a deemed s 12AC(6) enquiry to seek a formal closure notice of that enquiry so that there is no risk of matters being reviewed afresh several years down the line.