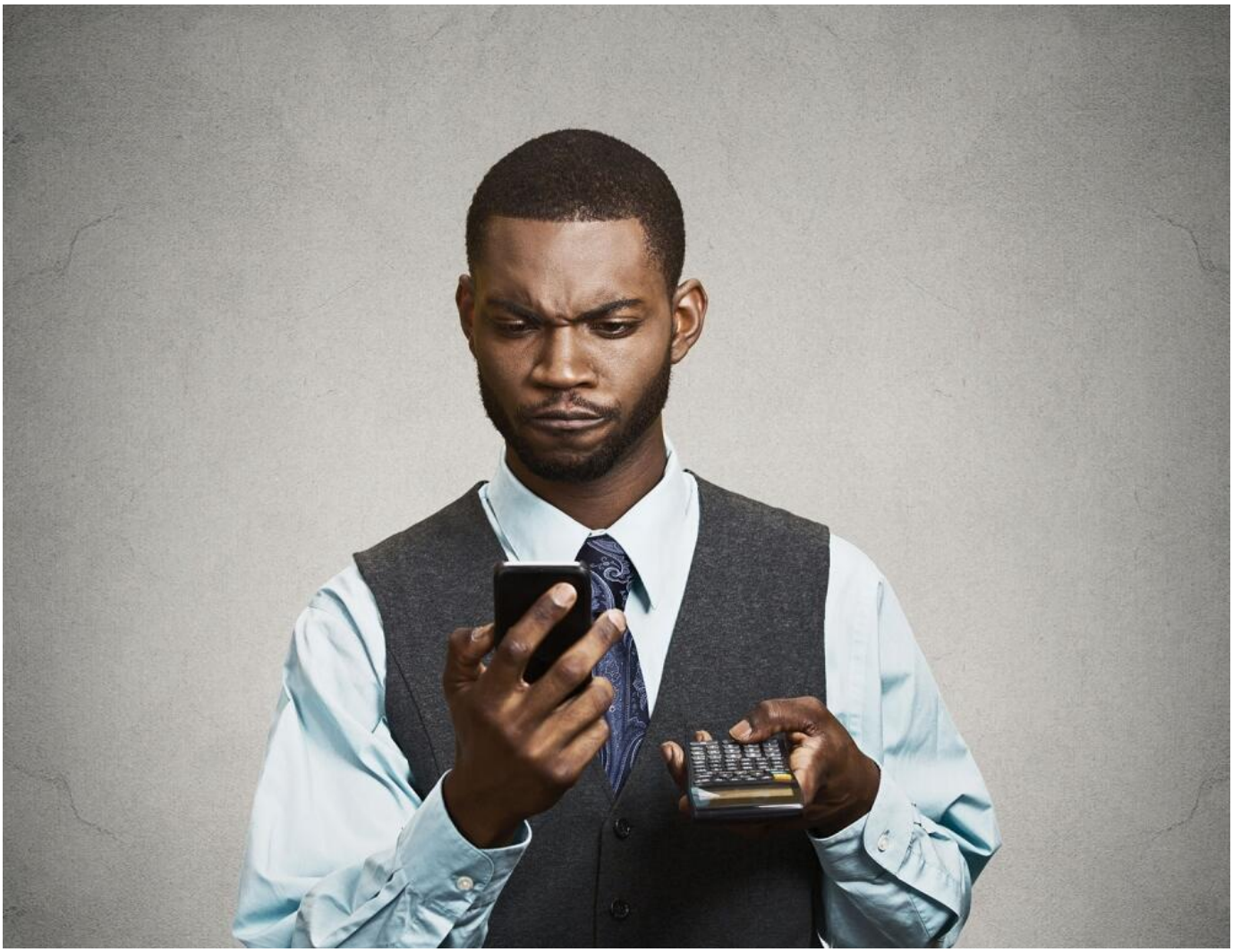
Fatal distraction

Personal tax



29 October 2020

Keith Gordon considers a case where a taxpayer asked the High Court to correct an inadvertent error on his tax return

Key Points

What is the issue?

The High Court has the power to correct mistaken documents, for example where a written contract misstates the terms of the agreement between the parties, so as to reflect the terms actually agreed by the parties.

What does it mean for me?

The case of Allan Firth Webster concerned an error made in a tax return that impacted a claim for Gift Aid on a large donation to charity. The Master of the High Court found that tax returns, by their very nature, fell outside the range of unilateral documents that were capable of rectification by the court.

What can I take away?

Taxpayers should pay particular attention when it comes to making carry-back elections.

If such an election is being contemplated, the taxpayer should delay sending in his/her tax return (not beyond 31 January, of course) to ensure that the opportunity is not missed.

One of the things I discovered during my legal studies was that the High Court has the power to correct mistaken documents. For example, if a written contract misstates the terms of the agreement between the parties, the High Court can, by declaration, rewrite the document so as to reflect the terms actually agreed by the parties. It is not a power that is liberally applied and it is subject to the court's discretion in accordance with what are known as the maxims of equity. This power is similar to that whereby the court can undo a transaction entered into by error in cases where 'it would be unconscionable, or unjust, to leave the mistake uncorrected' (per the Supreme Court in Pitt v Holt [2013] UKSC 26, see my article 'One Futter in the grave for Hastings-Bass (mistake and rectification)' in the July 2013 issue of Tax Adviser).

This article concerns the recent case of Allan Firth Webster [2020] EWHC 2275 (Ch), where the taxpayer sought the High Court's intervention to correct an error made on his tax return.

The facts of the case

Mr Webster's wife died on 4 August 2016. In her memory, Mr Webster established a charitable foundation. In the same tax year, Mr Webster sold his entire share capital in two companies, realising capital gains of over £5.3 million.

On 4 August 2017 (the first anniversary of his wife's death), Mr Webster made a donation to the charity of £800,000 on which he claimed relief under Gift Aid. When doing so, Mr Webster was fully conscious of the fact that he could elect to carry back the donation so that it could be treated as having been made in the previous tax year (2016/17). Indeed, although not strictly necessary, the Gift Aid certificate was annotated to refer to the fact that the donation would be carried back by Mr Webster.

The decision to carry the election back was important to Mr Webster because he had significant income and gains in the 2016/17 tax year but this was not the case in respect of the 2017/18 tax year. Indeed, there would be insufficient tax liabilities arising in the later tax year to support the Gift Aid claim.

Prior to making the gift in August 2017, Mr Webster had contemplated making a gift of £400,000. However, by 4 August, he changed his mind and increased the sum to £800,000. The problem for Mr Webster was that he had already started to compile his tax return (using commercial software) and provisionally entered the figure of £400,000 (as per his original intention). Mr Webster then failed to amend this figure to £800,000 before submitting his return in November 2017.

In early 2018, Mr Webster spotted the error and notified HMRC. He was led to assume that this would not be a problem. Consequently, when HMRC opened an enquiry into the 2016/17 tax return, Mr Webster was not unduly concerned.

However, HMRC subsequently advised Mr Webster that it could not amend the return to reflect the full amount of the gift. HMRC cited the First-tier Tribunal's decision in Cameron v HMRC [2010] UKFTT 104 (TC), which held that a carry-back election must be made by the taxpayer in an original tax return and not via any amendment to the return

On that basis, it would seem that Mr Webster would have to forgo approximately one half of the relief in respect of his donation, as the other half would be stranded in the 2017/18 tax year.

However, the position for Mr Webster was in fact potentially far worse than this. HMRC had focused on the wording of the Income Tax Act 2007 s 426 (which governs carry-back elections). That section repeatedly refers to ‘the gift’ and does not expressly cater for parts of a gift.

On HMRC’s interpretation, the returned figure of £400,000 is completely wrong as there was no gift of such amount. When closing the enquiry into Mr Webster’s tax return, HMRC had therefore removed the £400,000, meaning that none of the donation was related back to the 2016/17 tax year (meaning that the full amount of £800,000 is stranded in 2017/18 tax year).

As the Cameron case suggests that Mr Webster cannot take any steps within the statutory scheme to correct his error, he sought the intervention of the High Court.

The High Court’s decision

The case came before Master Kaye. The Master acknowledged that unilateral documents are as capable of rectification as are bilateral ones. Indeed, I would say that this is clearly demonstrated by the case of Joost Lobler v HMRC [2015] UKUT 152, which concerned an investor’s request to make a partial disposal of his life policies (as discussed in my June 2015 article, ‘Joost busters’). But the Master then proceeded to say that tax returns, by their very nature, fell outside the range of unilateral documents that were capable of rectification by the court.

Even if she were wrong on that, she felt that the equitable jurisdiction of the court is ousted by the fact that the amendment of tax returns is governed by a clear statutory procedure – the combination of HMRC being able to correct obvious errors within nine months of the filing date, taxpayer amendments within a year of the statutory filing date, and amendments by HMRC following enquiries commenced within a similar period.

Furthermore, the Master felt that this was not a case that merited the equitable intervention of the court, as Mr Webster should have taken more care over the submission of his tax return. For these reasons, the Master declined to give the relief sought by Mr Webster.

Commentary

I was not personally convinced that the Master was correct when she decided that the nature of tax returns meant that they fell outside the scope of the court's supervision. I cannot see any principle that puts tax returns into a class of their own. For example, are they so fundamentally different from, say, a company's board minute agreeing to pay a dividend of a certain amount to its shareholders?

On the other hand, given the clear statutory procedures laid down for amending tax returns, I would be tempted to agree that the court's jurisdiction has been superseded by the legislation.

In other words, I agree with the Master's ultimate conclusion on this point, even if I would take a different route to get there.

This therefore makes moot the question of whether the court should exercise its equitable discretion to amend the return. However, what did concern me was a suggestion that HMRC had indicated that this was a case amounting to carelessness as understood under the penalty code, an indication with which the Master did not disagree. In the Master's view, that carelessness would have militated against the exercise of the court's discretion. Whether or not that is right, I did sense a feeling of outrage when I inferred that HMRC was seeking to compound Mr Webster's misery by imposing a penalty on top of all the additional tax that he might have to pay. This is not exactly an appropriate reward from the state for making a philanthropic gesture. The problem is that whenever mistakes are perceived in tax returns, there is a tendency from many HMRC officers to assume that it is a consequence of careless behaviour by the taxpayer, so that a penalty can be levied as well.

However, even if Mr Webster's predicament can be said to arise from carelessness, is it fair to say that a penalty should be imposed under the legislation? (If there were ever a case for special circumstances, this surely must be it.)

In any event, to decide whether a penalty should be imposed, I think one then has to ask a philosophical question as to what was the nature of Mr Webster's error? Was it to include in the return a figure of £400,000 instead of £800,000 or was it to include the figure of £400,000 rather than nil? In my view, the correct answer is the former rather than the latter. However, if that is the case, then the error has led to an erroneous increase in the amount of tax payable (because only half of the gift is relieved). Since penalties are charged by reference of the additional amount of tax payable to correct the error, this means that there should be no penalty payable. (I

do not go so far as to suggest that there should be a negative penalty, meaning that HMRC is liable to Mr Webster!)

This is, however, of secondary nature to the real dispute (or disputes) that Mr Webster finds himself embroiled in.

- First, the Cameron point. Does the statute allow carry-back elections to be made in amended tax returns (at least if the amendment is made before the 31 January following the end of the tax year)?

- Secondly, on a related point, can any correction be made to a carry-back election in the course of a s 9A enquiry into the tax return? Also, where a disagreement remains, is that capable of resolution by the First-tier Tribunal on the taxpayer's appeal against the closure notice?

- Finally, may carry-back elections be made in respect of any part of a single gift?

Addressing these in turn:

- Although it gives rise to a most unfortunate outcome, it is hard to see that the Cameron case was wrongly decided. Section 426(6) makes it clear that the election must be made 'on or before the date on which the individual delivers a return for [the earlier] year'.

- However, this does not mean that Mr Webster should be precluded from winning at the First-tier Tribunal.
  He clearly made his election in time. His error was to refer to the wrong amount. Indeed, if HMRC is right about the all or nothing approach of s 426, then there is no reason why a single error in the amount shown must lead to the inevitable conclusion that the election is to be disregarded in its entirety. The purpose of statutory enquiries (and subsequent tribunal proceedings) is to ensure that tax returns are corrected, not simply for tax reliefs to be deleted because of an error at the data entry stage.

- Thirdly, there are plenty of cases where the courts have stretched the meaning of words (or, in extreme cases, rewritten the provisions altogether) to interpret the statute in accordance with common sense.
  In this case, HMRC's argument would amount to saying that Mr Webster is

> entitled to no tax relief because he sent the charity a single cheque of £800,000, but the outcome would have been different had he written two cheques of £400,000. Such artificial steps are usually frowned upon and there seems to be no reason why Mr Webster should be treated less favourably simply because he did not take this precaution.

It is my sincere hope that Mr Webster will successfully persuade the tribunal that it is not bound by Cameron to refuse to allow the election to be corrected (to show £800,000); but that if this is wrong, s 426 is not to be read so as to preclude carry-back elections from applying to parts of gifts made. In the meantime, this looks like an area ripe for statutory reform as there seems to be no good reason for the statute to contain three different bear traps in a provision that is meant to encourage charitable giving.

What to do next

Given the state of the law at present, it is clear that taxpayers should take particular attention when it comes to making carry-back elections. If such an election is being contemplated, the taxpayer should delay sending in his/her tax return (not beyond 31 January, of course) to ensure that the opportunity is not missed. Secondly, care needs to be taken to ensure that carry-back elections are made in respect of the whole amount of any particular charitable donation.