TAXAdviser

Considered revelations

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Sharon McKie and *Simon McKie* examine disclosure in self-assessment returns in the light of the increasing number and intensity of HMRC's enquiries into matters of residence and domicile

What is the issue?

Determining domicile often requires a detailed historical enquiry to acquire evidence proving the intentions of the taxpayer concerned and, often, the intentions of his father and, sometimes, of his mother and ancestors at multiple times in the past.

What does it mean to me?

The costs of dealing with an ill-informed HMRC officer making ill-considered, blanket demands for information, both relevant and irrelevant, in a piecemeal fashion over an extended period is likely to be several times the cost of dealing with an enquiry where such a duly considered and comprehensive disclosure has been made with the return.

What can I take away?

In determining whether complex sets of facts fall within two such vague and imprecise concepts, one can rarely reach a conclusion which has practical certainty. The best the taxation adviser can usually achieve is a conclusion which he considers probable and some evaluation of the degree of probability.

The importance of residence and domicile

Most taxing jurisdictions determine the extent to which they subject a person to tax by reference to short- and long-term connecting factors.

In the UK tax system, these factors are respectively residence and domicile. Both, even after the enactment of the

Statutory Residence Test in the Finance Act (FA) 2013, are concepts of the upmost complexity and imprecision.

Determining residence and domicile requires detailed historical enquiry

Determining domicile often requires a detailed historical enquiry to acquire evidence proving the intentions of the taxpayer concerned and, often, the intentions of his father and, sometimes, of his mother and ancestors at multiple times in the past.

Lord Wilson SCJ famously said in the case of *Gaines-Cooper (R (on the application of Davies & Another)) v HMRC* and *R (on the application of Gaines-Cooper) v HMRC* [2011] STC 2249 at para 20) that determining a person's country of residence may require 'a multifactorial inquiry.'

Even though the Statutory Residence Test has been enacted since *Gaines-Cooper* was decided (in FA 2013 s 218 and Sch 45), such is the imprecision of the concepts used in that test that a multifactorial enquiry is still required to determine residence in all but the simplest cases.

The interconnectedness of residence and domicile

For Inheritance Tax purposes, since the tax's inception, an individual has been treated as if he were domiciled in the UK if he is resident here for an extended period (Inheritance Tax Act 1984 (IHTA 1984) s 267). Similar provisions were enacted for many purposes of Income Tax and Capital Gains Tax by the Finance (No. 2) Act 2017 s 29(1) with effect from 6 April 2017 (Income Tax Act 2007 (ITA 2007) s 835BA). So in order to determine how an individual is taxed, one often has to determine both his country of domicile and his country of residence for many fiscal years, including years before the enactment of the Statutory Residence Test. Doing so often requires the gathering and evaluation of detailed and voluminous evidence relating to many years.

Certainty is unobtainable

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The problem of uncertainty

That poses, with particular acuteness, three problems with which tax advisers are always faced to some degree.

- *Guarding against penalties*: First, how does one minimise the chances of penalties being imposed in the event that, in due course, the Tribunal takes a different view of the correct taxation treatment of one's client's transactions from the treatment reflected in his returns?
- *Finality*: Secondly, how does one give one's client the best possible chance that assessments made on the basis of the treatment reflected in his returns will become final once the statutory enquiry period has expired?
- *Balancing immediate and future costs*: Finally, how does one minimise the costs of an enquiry by HMRC into one's client's residence and domicile status and how does one balance the costs of comprehensive disclosure in the client's tax return against the uncertain costs of a future enquiry?

Guarding against penalties

A person who submits a tax return on the basis of a view of his residence or domicile which affects his Income or Capital Gains Tax liability with which the Tribunal or Court in due course disagrees will have submitted a return containing an inaccuracy. FA 2007 Sch 24 para 1 imposes a penalty on a person where, *inter alia*, that person gives to HMRC a self-assessment tax return under Taxes Management Act 1970 (TMA 1970) s 8 and two conditions are satisfied. The first condition is that the document contains an inaccuracy which amounts to, or leads to, an understatement of a liability to tax, a false or inflated statement of a loss or a false or inflated claim to a repayment of tax (FA 2007 Sch 24 para 1(2)). The second condition is that the inaccuracy was careless or deliberate (FA 2007 Sch 24 para 1(3)).

The burden of proving that the inaccuracy was careless or deliberate falls on HMRC (see *Gardiner v HMRC* [2014] UKFTT 421 (TC) and *Burgess, Brimheath Developments Ltd v HMRC* [2015] UKUT 0578 (TCC) at para 38). HMRC accept that this is the case (see HMRC's Compliance Handbook Manual para CH81122) but, in practice, it is prudent for the taxpayer to preserve evidence to rebut a contention by HMRC that the inaccuracy was careless or deliberate.

A person is liable to a penalty for the submission of an inaccurate document where the document is given to HMRC on that person's behalf. He will not, however, be liable in respect of anything done or omitted by his agent where he satisfies HMRC that he took reasonable care to avoid the inaccuracy (FA 2007 Sch 24 para 18(3)). A taxpayer wishing to ensure that a penalty will not be imposed for an inaccurate document, therefore, would do well to preserve evidence that he has appointed a tax agent with the requisite qualifications to correctly complete his tax return, he has no reason to think that the agent would not do so competently and efficiently and that he has provided the agent with all the information which the agent has specifically requested or which the client might reasonably have supposed was necessary for the agent to complete his return on his behalf accurately.

This evidence might, of course, be preserved merely by way of retaining correspondence and other relevant documents. It is useful, however, to submit a detailed disclosure with the relevant tax return to HMRC which, by setting out all of the relevant facts and analysis, demonstrates the care taken. As we shall see, doing so is also essential if the client is to have the highest practical chance of obtaining finality once the period for HMRC to enquire into his return has expired.

Finality

TMA 1970 ss 34, 36 and 36A – extended time limits

TMA 1970 s 34 provides a general rule limiting the period during which an assessment to Income Tax or Capital Gains Tax can be made to not more than four years after the end of the year of assessment to which the assessment relates.

Longer periods for assessment, however, apply, under TMA 1970 s 36, where a loss of Income Tax or Capital Gains Tax is brought about carelessly (extending the period to six years) or deliberately (extending the period to 20 years) by the person assessed. For this purpose, a loss brought about by the person assessed includes a loss brought about by another person acting on his behalf (TMA 1970 s 36(1B)). So if a taxpayer's tax agent makes a careless or deliberate error in a self-assessment return submitted on the taxpayer's behalf, the taxpayer may be assessed under the extended time limits even if he has taken all reasonable care to avoid the inaccuracy.

TMA 1970 s 36A extends the time period for assessment to 12 years for losses of Income Tax or Capital Gains Tax which are not brought about deliberately and which relate to an offshore matter or transfer.

Discovery

The time period within which HMRC may make an assessment is further restricted by the discovery provisions.

If HMRC's assessment to Income Tax and Capital Gains Tax on an individual is not made in the course of, or on the closure of, an enquiry, it may be made under TMA 1970 s 29 on the making of a 'discovery'. Where tax which ought to have been assessed has not been assessed due to an error in an individual's self-assessment return, if the enquiry period has ended without an enquiry being raised or an enquiry into the relevant year has been closed, the under-assessed tax may only be assessed under TMA 1970 s 29 and then only if one of two conditions is satisfied (TMA 1970 s 29(3)).

The first condition is that the under-assessment ‘was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf’.

The second condition is that at the time when an officer of the Board ceased to be entitled to give notice of his intention to enquire into the taxpayer’s return in respect of the relevant year of assessment, or in a case where a notice of enquiry into the return has been given the time when a partial or final closure notice in respect of the under-assessment is issued, ‘the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware’ of the under-assessment (TMA 1970 s 29(4) & (5)).

So, if the under-assessment has not been brought about by a careless or deliberate error in the return, no assessment may be made after the time when the enquiry window closed (under TMA 1970 s 9A(2)) (which will normally have been 12 months after the day on which the return was delivered) if, at that time, ‘the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation [leading to the under-assessment].’

The information made available for this purpose is narrowly defined (TMA 1970 s 29(6) amendments to this sub-section are to be made under F(No.2)A 2017 ss 6(1) and Sch 24 para 20(2)&(3) with effect from a day to be appointed).

The prudent course, therefore, is for an adviser to advise his client that if anything in his tax return is dependent on his residence and/or his domicile, the ‘white space’ in his tax return should refer to an attached document which sets out all the information relevant to determining the status concerned at the relevant dates and an analysis which determines the status by applying the information to the law relevant to determining the status concerned.

Balancing immediate and future costs

Careful drafting

If such a disclosure is to achieve its purpose it must be very carefully drafted to ensure that all relevant information, not just the information favourable to the treatment adopted by the taxpayer, is included and that all relevant technical issues are covered and that arguments unfavourable to the taxpayer are objectively set out so as to demonstrate that the taxpayer has considered them and has reasonably concluded that they are invalid.

Indeed, there will be matters where the treatment adopted is simply, as a matter of judgement, more likely than not to be the correct construction of the relevant law so that the opposing arguments are not invalid but merely less likely to be correct than those on which the treatment adopted by the taxpayer is based. If that is the case the disclosure should say so.

An additional benefit of such a disclosure is that it enables the taxpayer to demonstrate to HMRC that the treatment adopted is, indeed, the correct, or at least the most supportable, one so that time is not wasted, as it so often is in HMRC enquiries, with HMRC starting from a position which is unsupportable on the law or the evidence.

HMRC’s standard lists of requested information and documents

HMRC’s Residence, Domicile and Remittance Basis Manual gives, at para RDRM23080, a list of ‘the types of information that might be requested during an enquiry’. It lists 41 categories of information and 27 categories of documents. The paragraph says that ‘any information request should be tailored to the particulars of the individual’s claim’ but, as discussed below, it is clear that HMRC officers are routinely demanding all or most of the information in the list without first considering its relevance.

The equivalent section in the Manual concerning residence enquiries has been withheld from publication under ‘exemptions in the Freedom of Information Act 2000’ (HMRC’s Residence, Domicile and Remittance Basis Manual para. RDRM10635). Anecdotal evidence suggests that HMRC officers, in respect of residence matters, are also routinely using some form of checklist to demand information and documents without properly considering the relevance to the taxpayer concerned of the information requested.

Although HMRC's indifference to the burden placed on taxpayers by its indiscriminate demands for irrelevant information is reprehensible, where a taxpayer's return is to include a comprehensive disclosure in respect of his residence and/or domicile, the taxpayer is best served if his adviser gathers, before he provides his advice, all the information and documents which HMRC is likely to request if an enquiry is launched and by his tax agent providing with the taxpayer's disclosure a comprehensive statement of that information, including the information contained in the documents referred to its sources, unless it clearly cannot be relevant. Any apparent inconsistencies in the information and documents can be explained in the disclosure so that the information is placed in its proper context.

A costly process

The trouble with such an approach is that such a disclosure requires the input of a considerable amount of expensive professional time and for the drafter to have considerable technical and literary skills, skills which command a high hourly rate. It therefore involves a considerable initial investment.

The tax at stake in smaller cases will often not justify such an investment. It is a fundamental failure of our tax system that it has become so complex that many taxpayers simply cannot afford to determine their tax liabilities with reasonable accuracy and to a reasonable level of probability.

The increased frequency and indiscriminate vigour of HMRC's enquiries

Even taxpayers with larger sums at stake, may be tempted to skimp on this initial expense in the hope that their domicile and/or residence status will not be enquired into by HMRC. In the past, such an approach, although in most cases unethical, may have been the course of action which generally produced the most favourable results for taxpayers. HMRC's enquiries into domicile and residence matters were woefully inadequate and unethical taxpayers were tempted to make claims not to be domiciled or resident in the UK which were unjustified in the knowledge that such claims were unlikely to be enquired into by HMRC with any vigour.

Where the tax at stake is significant, the probability of avoiding an enquiry into transactions treated on the basis that the taxpayer is non-UK resident or non-UK domiciled is now very small. Even where the tax at stake is quite modest, it would be very unwise to assume that the relevant return will not be the subject of an enquiry. HMRC has greatly increased the number and the intensity of its enquiries into domicile and residence questions. Unfortunately, it has not done so in a rational, proportionate or ethical manner.

Members of the major professional bodies concerned with taxation have reported that, in its conduct of domicile enquiries, HMRC now routinely asks for a very extensive standard list of information and documents from the client regardless of the relevance of the items requested, abuses the issue of information notices, and conceals its position and concerns in the early stages of the enquiry process, thereby unnecessarily prolonging its enquiries. Members have also reported that HMRC's officers lack an understanding of the basic legal concepts, write so poorly that they are unable to communicate accurately their requests and position to the taxpayer, and treat taxpayers generally as if they were dishonest and with unconcealed hostility and aggression.

The result of such behaviour is that the vulnerable and, in particular, the elderly, are so intimidated that there is a serious risk that they will make settlements which are not in accordance with the law.

The best policy

The best way of minimising the risk of one's clients being treated in this way and of resisting such treatment when it arises is for a client to make with his return a full and considered disclosure of the type we have described. The costs of dealing with an ill-informed HMRC officer making ill-considered, blanket demands for information, both relevant and irrelevant, in a piecemeal fashion over an extended period is likely to be several times the cost of dealing with an enquiry where such a duly considered and comprehensive disclosure has been made with the return.
