

## **A discovery assessment (Lecture P1339 – 15.41 minutes)**

The decision in *Johnson v HMRC* (2022) was published by the First-Tier Tribunal on 4 May 2022. This is an interesting case which concerned a discovery assessment for 2013/14 issued in November 2018 under S29(4) TMA 1970 on the basis that the insufficiency of tax was brought about carelessly or deliberately by the taxpayer or by a person acting on his behalf.

In January 2014, the taxpayer (J) had received a compensation payment from NatWest in respect of an interest rate financial hedging product following a review by the Financial Conduct Authority. HMRC considered that such receipts were taxable and said so in guidance which can be found on their website. J's tax adviser was aware of the HMRC guidance but felt that there was ambiguity in relation to the taxability of this particular receipt. Accordingly, disclosure was merely made in the white space of J's self-assessment tax return for 2013/14.

A full disclosure of the relevant details in the white space of a tax return provides a defence to a discovery assessment by reason of S29(5) TMA 1970 on the ground that the HMRC officer could reasonably be expected to be aware of the insufficiency as a result of the information provided by the taxpayer. Unfortunately, however, this defence does not hold good for discovery assessments made under the 'careless or deliberate conduct' provisions of S29(4) TMA 1970 – it only applies to the 'reasonable expectation' requirements in S29(5) TMA 1970.

In other words, the issue in this case was whether J's adviser had been 'careless'.

The First-Tier Tribunal held that J's adviser had been careless and that the discovery assessment was valid. The adviser knew about the HMRC guidance and should have included the receipt as part of J's taxable business income. He was careless not to have done so. The guidance which the adviser read makes it clear that such redress payments should be treated as business income – J was in receipt of rental income from a property which he had purchased with the aid of a loan several years ago. The compensation payment related to that loan. Property profits constitute a form of business income. Although the adviser had seen HMRC's guidance which suggested that, if the redress product related to a non-business loan, the payment was not taxable as income, it was, in the First-Tier Tribunal's view, unbelievable that an experienced practitioner such as J's adviser would not be aware that letting out property represented a business and that the payment should have been treated as taxable.

However, one experienced commentator has made this point:

'This seems a bit tough. (The adviser) was careless just because he did not follow HMRC's guidance but put the details in the white space. The First-Tier Tribunal accepted that there may have been some ambiguity but said that an experienced . . . adviser would have thought it pretty likely that the receipt would be taxable. This (seems to be) a new test – and it is not clear why a new test is required, having regard to the well-established test for carelessness.'

Tax legislation defines carelessness as a failure by the taxpayer to take reasonable care. When the harmonised penalty regime was introduced several years ago, the idea of failure to take reasonable care was likened to the general law concept of negligence.

Although the old case of *Blyth v Birmingham Waterworks Co* (1843–60) gave a definition of negligence which has often been cited in the First-Tier Tribunal and its predecessors, it is nowadays

thought that a modern formulation of what constitutes a failure to take reasonable care such as that found in *Collis v HMRC* (2011) is more appropriate.

Thus:

‘We consider that the standard by which this falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question.’

It is not clear whether – to summarise the First-Tier Tribunal – an experienced adviser would have thought it ‘pretty likely’ that the redress payment was taxable corresponds to the test enunciated above. Maybe it does.

Finally, however, the following question has to be asked: what protection does a white space disclosure provide? Not much, it seems. If the conclusion from the information in the white space is correct, then one does not need to have made the disclosure at all. And, if it is wrong, the taxpayer or his adviser must have been careless – which puts one in the same position as if one had not made any disclosure. Can this really be correct?

*Contributed by Robert Jamieson*