Low Incomes Tax Reform Group.

A voice for the unrepresented.

Finance (No. 2) Bill 2021 – Clause 95
Discovery Assessments
Briefing from the Low Incomes Tax Reform Group (LITRG)

1 Executive summary

1.1 This measure changes when HMRC can issue a 'discovery assessment' (a way of collecting unpaid tax) so that it is beyond doubt they may be used to collect standalone tax charges, such as the high income child benefit charge (HICBC). The change has retrospective and prospective effect, except for certain taxpayers who had already appealed on the basis that HMRC's existing power is inadequate.

1.2 We have concerns about the way the change is being introduced retrospectively. This is not just because of the principle of retrospection, but also because the exception introduces unfairness on those who did not make the necessary appeal and on those who already paid the charges when they were due. However, alternative ways of introducing the change present their own difficulties. We explore some of these below.

1.3 The fundamental problem here is a lack of awareness by taxpayers that despite the State paying them, or their partners, child benefit and, in most cases, taxing their salaries through PAYE, they nevertheless have the obligation to notify the State specifically of their obligation to pay this charge: there has been very limited progress on Office of Tax Simplification recommendations for addressing this and other difficulties associated with the charge.

2 About Us

2.1 LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Overview of measure

3.1 This measure amends HMRC's power to issue a discovery assessment to make good a loss of tax. It aims to ensure the law is clear that discovery assessments can be used in cases where the taxpayer had not notified HMRC about certain standalone tax charges, such as the high income child benefit charge (HICBC). This change has been proposed following a legal challenge (that has been successful, so far) regarding HMRC's ability to use discovery assessments in certain HICBC cases.[1]

3.2 Our understanding is that the Government intend the change to apply both retrospectively and prospectively, so that:

- Those discovery assessments which have already been issued in relation to HICBC, other than those described in the next bullet, will no longer be appealable using the *Wilkes* argument (see footnote 1).
- Those discovery assessments which have been appealed on or before 30 June 2021, either using the *Wilkes* argument or which are stood behind *Wilkes*, will have their position determined by the final outcome of *Wilkes*.
- HMRC will be able to issue new discovery assessments, which will not be appealable using the *Wilkes* argument, in relation to HICBC.

4 General comments

4.1 LITRG considers that the HICBC, despite its name, is an issue within its remit for two main reasons. First, it is an issue which unrepresented taxpayers can easily fall foul of because of lack of awareness about how the charge applies. Second, although the charge nominally

[1] On 30 June 2021, the Upper Tribunal decided in *HMRC v Wilkes* [2021] UKUT 0150 (TCC) that HMRC's discovery powers did not allow them to assess the HICBC on Mr Wilkes. This was because the HICBC is a standalone charge to tax, not a tax on income, and there was no discovery of any income which had not been assessed ('the *Wilkes* argument'). HMRC's position is that their existing powers *do* allow this, and they are appealing the *Wilkes* decision to the Court of Appeal.

applies to the higher-income partner, it indirectly affects households which may include a lower-income child benefit claimant. The number of families affected by the charge has increased substantially since it was first introduced because the £50,000 threshold has not been uprated for nine years (with the result that it now affects some basic-rate taxpayers). In any case, the household income of a household with children and a single earner of more than £50,000 pa is likely to be at a much lower position in terms of income distribution percentiles of the population, than is the individual themselves, viewed in isolation.

4.2 We do not object to the prospective change (the third bullet in paragraph 3.2), as it brings the discovery assessment power, where exercised in the future, into line with HMRC's existing power under Simple Assessment. We urge HMRC to work on improving the fairness and consistency with which it responds to taxpayers who have a reasonable excuse for the failure to notify, so that the assessing power is limited to the last four years where they had a reasonable excuse for non-disclosure. ('Reasonable excuses' are often not accepted by HMRC who, unusually nowadays, lose many tribunal cases on this issue where the taxpayer is prepared to pursue the matter that far.)

4.3 However, the change also has retrospective effect – not only in relating to periods in the past but in legitimising potentially defective assessments already made. Given the situation that has been created, it is difficult to apply this retrospection while being fair to all taxpayer groups. The proposed approach disadvantages those in the same position as the taxpayer in *Wilkes* but who had not made the necessary appeal – even though, as it currently stands, the Upper Tribunal has decided that the discovery assessments raised against them were not issued legally. It also disadvantages those who appealed between 30 June 2021 and the date of the Budget announcement. On the other hand, it also means that those who are excluded from the change may not need to pay the charge for the appealed assessments, even though HMRC had other means of collecting the tax at the time, the charges were indisputably due, and many others in similar circumstances had paid the charge all along.

4.4 There are a number of possible alternative approaches, but none of them fully address all the different fairness issues that arise for different groups and some arguably create further unfairness. We discuss some of these in our detailed comments on this aspect below.

4.5 There is an unappealing contrast between the zeal with which HMRC and the Government are pursuing individual taxpayers, first through the tribunal system, and secondly through retrospective legislation when an early tribunal result was unfavourable, and the relative lack of progress in implementing the proposals of the Office of Tax Simplification (OTS) to address the issues caused by lack of public awareness of the charge and the potential obligations it imposed to make specific disclosures of matters already, in a sense, known to the State. The charge was introduced in 2013 and known from the outset to be challenging to implement because of the interaction of the different systems, based on different criteria,

for taxing income and paying child benefit, which do not 'talk to' each other.[1]

5 Detailed comments on retrospective aspect of the measure

5.1 Before considering the retrospective aspect of the change in more detail, we assume the intended operation of the change is that it will apply retrospectively to those who have *already been issued* with discovery assessments (unless they had made the necessary appeal). We are not sure that clause 95(3) achieves this, at least not with clarity, as it appears to apply to discovery assessments made 'in relation to' (i.e. for) 2020/21 and earlier. Assuming the intention is for the change to apply also to discovery assessments issued for those years prior to this Bill receiving Royal Assent, it would be clearer if the legislation were to expressly state this.[2]

Background: alternatives to discovery assessments and their time limits

5.2 HMRC's discovery assessment power needs to be considered in context with other powers which HMRC already have in order to make good a loss of tax. These include issuing the taxpayer with a notice to file a Self Assessment tax return, or issuing a Simple Assessment. Each of these powers has different time limits, which are shown below for a taxpayer who has failed to notify liability to HMRC (assuming the failure is neither careless nor deliberate):

Power	Time Limit
Discovery assessment (s29(1)(a) TMA)	Where a taxpayer has a reasonable excuse for the failure to notify: 4 years Otherwise: 20 years (though for tax years prior to 2010/11, negligent conduct is required)
Simple Assessment (s28H TMA)	Where a taxpayer has a reasonable excuse for the failure to notify: 4 years Otherwise: 20 years (though not for tax years prior to 2016/17)

[1] The OTS recommended in their October 2019 report, *Taxation and life events*, that, *inter alia,* improvements should be made on behalf of those who might miss out on national insurance credits as a result of the charge. See https://www.gov.uk/government/publications/ots-life-events-review-simplifying-tax-for-individuals, p23. Other than updating the wording on the child benefit claim form, we are not aware of any other progress which has been made towards these recommendations.

[2] For example, when retrospective changes were made by s103 FA 2020 on the use of automated decisions by HMRC, s(103)(5) states clearly "this section is treated as always have been in force".

Issuing a notice to file a Self Assessment tax return (s8 TMA)	4 years in all cases

5.3 It should also be noted that, if HMRC have agreed that a taxpayer has a reasonable excuse for the failure to notify, then **the time limit is the same in each case**.

Retrospection: the Government's current approach

5.4 The Government's current approach is to exclude from the retrospective effect of the change those who appealed on or before 30 June 2021 using the *Wilkes* argument. This means that certain taxpayers (Mr Wilkes included) might not need to pay charges which were legally due, and about which they were notified within the standard 4-year time limit, but which are now too late for HMRC to assess by other means. It is arguable that this is not fair on those who: paid the charges on time; did not 'spot' the legal issue on which the *Wilkes* argument is based; or chose not to appeal knowing that HMRC might have simply asked them to file Self Assessment tax returns for those years instead.

5.5 We also note an unfairness with the Government's proposed approach on behalf of those who appealed after 30 June 2021 but before the date of the Budget announcement. Under the Government's plan, such taxpayers are not protected from the retrospective effect of the change – even though they might have incurred costs in making an appeal in accordance with sound legal advice at the time.

5.6 Some alternative approaches could be as follows:

- apply the change only prospectively with no retrospective effect at all;
- limit the retrospective effect only for discovery assessments in relation to tax years which were less than four years old at the date of issue (with or without an exception for those who appealed);
- make the proposed change have full retrospective effect, with no exception for those who had appealed.

It would also be possible for the government to address some of the issues in the proposed legislation by adopting a mixture of these approaches.

No retrospective effect

5.7 One way of equalising the position between those who had appealed and those who had not is for the change not to apply retrospectively at all. The main challenge here is the issue of fairness with all those who paid the charges in accordance with their legal duty to do so.

5.8 This approach would **not** mean that all previously issued discovery assessments would automatically become invalid, but that taxpayers would be able to submit an appeal (albeit potentially late) using the *Wilkes* argument.

5.9 This approach may also have implications for the Exchequer as HMRC are now out of time to assess tax years prior to 2016/17.

Time-limited retrospective effect

5.10 A second option would be for the retrospective effect to apply only to tax years which were less than four years old at the date of issue. The rationale for this suggestion is that these are the tax years which HMRC were in time to assess using other means – assuming that the taxpayer had a reasonable excuse for the failure to notify.

5.11 Thus, on the one hand it acknowledges the ambiguity of the current legislation and the difficult position HMRC find themselves in, but it also puts the taxpayer in the same position as if that ambiguity did not exist and HMRC had used other means to collect the charge – while giving the taxpayer the protection afforded by a successfully argued reasonable excuse for the failure to notify. (Effectively taxpayers under this option would be given the 'benefit of the doubt' on the issue of 'reasonable excuse'.)

5.12 For earlier years, taxpayers would keep the option to appeal these assessments on the basis of the *Wilkes* argument. These are the tax years for which HMRC's ability to assess them depends on the precise wording of the discovery assessment power. Should the final outcome of *Wilkes* be in the taxpayer's favour, we would expect HMRC to take unilateral action to rescind these discovery assessments and refund taxpayers for these years accordingly.

5.13 There is good justification for assuming taxpayers had a reasonable excuse for the failure to notify in this context. Many taxpayers affected by the HICBC have argued that they have a reasonable excuse for the failure to notify in cases where they were unaware they should have done so.[1] With the high income child benefit charge, this is an especially pertinent issue given the number of cases in the courts where PAYE taxpayers have pleaded ignorance in the face of unaffordable tax demands from HMRC for several thousand pounds.

5.14 HMRC themselves have recognised that their own approach to reasonable excuse based on ignorance of the law has needed improvement to deliver fairness and consistency – effectively recognising that taxpayers have been treated unfairly and inconsistently in the

[1] This has been upheld multiple times at the First-tier Tribunal where HMRC have been unable to show they have specifically written to the taxpayer about the charge – despite HMRC's argument that they have no general obligation to inform taxpayers about changes in the law which may affect them.

past.[1]

5.15 It would seem to us that the widespread lack of awareness of the charge among those who have failed to notify HMRC of their liability to it justifies giving these taxpayers the benefit of the doubt.

5.16 How this might apply to an unrepresented taxpayer in this kind of situation who did not appeal the assessments is demonstrated by the following case study:

> *Sally received discovery assessments from HMRC in October 2019 assessing the HICBC for the tax years 2013/14 to 2016/17, together with penalties for failure to notify HMRC of her liability to the charge. During those years, she was living with a partner, Patrick, who was claiming child benefit for his two children. Sally had never heard of the HICBC and didn't know about her liability to it. Because the couple had no joint financial interests other than sharing the rent, she didn't know about his child benefit claim. On receiving the assessments, Sally thought the tax charge was unfair, but when she looked into it, she realised the rules did apply to her as HMRC said. Although she was unhappy about it, she made a Time-to-Pay arrangement with HMRC to pay the penalty and the tax without appealing.*
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> *Sally recently heard about the* Wilkes *case and realised that her circumstances were similar. She thought that she might be able to get the money back from HMRC – or otherwise if she had to pay then so should Mr Wilkes. Instead, she is told that not only are the Government changing the law retrospectively to avoid potentially having to pay her back, but that Mr Wilkes (and others like him) are excluded from the change.*
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> *She thinks this is unfair by itself, but believes that the unfairness is compounded because she may not have needed to pay any penalties or the assessments for 2013/14 and 2014/15 if she had tried to argue that she had a reasonable excuse. Unfortunately, she is out of time to make that appeal.*
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> *Under this approach, the charge for tax years 2015/16 and 2016/17 would remain payable, but HMRC would (likely) refund the assessments and penalties for 2013/14 and 2014/15 if the final outcome of* Wilkes *is in the taxpayer's favour.*

5.17 Under this option, there is then a separate question about whether to protect taxpayers who had appealed their assessments from the effect of any retrospective change. This requires a balance between those taxpayers' rights to be able to pursue a legal challenge based on the law which applied at the time versus what is fair in a broader sense,

[1] See Section 7 of *Evaluation of HMRC's implementation of powers, obligations and safeguards introduced since 2012* (February 2021): https://www.gov.uk/government/publications/evaluation-of-hmrcs-implementation-of-powers-obligations-and-safeguards. HMRC have since updated their guidance on reasonable excuse, pursuant to Commitment 16.

considering the perspective of those who did not appeal and who paid the charges which were legally (and indisputably) due.

Full retrospective effect

5.18 One final option is that the change could apply retrospectively to **all** discovery assessments, including where taxpayers had appealed.

5.19 While this would also equalise the position between those who had appealed and those who had not, and potentially equalise the position compared to those who paid the charge, we feel that those who had appealed should be able to pursue their case based on the law which applied at the time. To retrospectively change the law would render the appeals process defunct for these taxpayers.

LITRG
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