[2017] UKFTT 385 (TC)

TC05851

Appeal number: TC/2015/02899

CAPITAL GAINS TAX – effect of claim for corresponding deficiency relief under section 539 ITTOIA 2005 on rates of tax on chargeable gains in tax years 2006/07 and 2007/08 – construction of section 4 TCGA 1992 and section 6(2) TCGA 1992

JURISIDCTION – whether the First-tier Tribunal has jurisdiction to consider argument that amendments made in closure notice invalid because HMRC had no power to enquire into its own calculation under section 9A TMA 1970 – construction of section 50(6) TMA 1970

PROCEDURE – enquiry under section 9A TMA 1970 – whether HMRC able to enquire into its own calculation

FIRST-TIER TRIBUNAL
TAX CHAMBER

ANDREW SCOTT **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE ASHLEY GREENBANK

Sitting in public at Royal Courts of Justice, Strand, London on 12 and 13 January 2017

Mr Michael Firth for the Appellant

Mr Simon Pritchard, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This decision relates to an appeal by the Appellant, Mr Andrew Scott, against two decisions of the Respondents, HMRC, contained in two closure notices, both dated 13 February 2015, one for the tax year 2006/07 and the other for the tax year 2007/08.

2. Mr Scott appeals against HMRC's decision that the rate of capital gains tax ("CGT") applicable to gains accruing to Mr Scott in each of those tax years was 40% rather than, as Mr Scott contends, 20%.

THE ISSUES BEFORE THE TRIBUNAL

3. There are two issues before the Tribunal.

4. The first issue concerns the interaction of provisions relating to availability of relief under section 539 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"), known as "corresponding deficiency relief" ("CDR"), and those relating to CGT. The detail of this argument is set out below, but, in summary. Mr Scott says that his claim for CDR affects the rate at which CGT is payable on his capital gains in the relevant tax years so that he is only liable to pay tax at the lower rate and not the higher rate. The parties referred to this first issue as "the substantive issue". I have used that term in this decision.

5. The second issue turns on the manner in which tax has been calculated and assessed in this case. Mr Scott's returns for the relevant tax years were submitted incorporating calculations of the tax due made using software based on HMRC's specifications. Those calculations showed tax payable on capital gains at the lower rate. Following enquiries under section 9A of the Taxes Management Act 1970 ("TMA"), HMRC issued closure notices charging tax on those gains at the higher rate. Mr Scott says HMRC was responsible for the way in which his tax liability was calculated in the relevant years and it was not open to HMRC to "enquire" into a calculation which HMRC had itself performed. The parties referred to this second issue as "the procedural issue". I have used that term in this decision.

THE HEARING AND THE EVIDENCE

6. I was provided with an agreed bundle of documents and authorities for the purpose of the hearing.

7. In the course of the hearing, Mr Firth also provided me with certain computations for income and gains of a notional taxpayer that were produced using the calculator on HMRC's website. I have accepted those computations in evidence.

8. The documents included witness statements of Mrs Maureen Crewe and Mr Keith Graham, both officers of HMRC. Mrs Crewe and Mr Graham both gave evidence and were cross-examined on their statements.

9. The evidence of Mrs Crewe and Mr Graham is of more relevance to the procedural issue and I have discussed the extent to which I have taken into account that evidence at the point in this decision where I discuss the procedural issue.

THE FACTS

10. The facts are not in dispute. The parties provided a statement of agreed facts, which is set out in Appendix 1 to this decision notice and which I adopt for the purpose of this decision.

11. The statement of agreed facts sets out in some detail the facts surrounding the preparation and submission of Mr Scott's tax returns for both relevant periods. In summary, Mr Scott's accountants attempted to file the return for the tax year 2006/07 electronically, but were unable to do so because of problems with HMRC's computer systems. The return was then filed in paper form. The tax calculation was performed using third party software which was based on HMRC's specifications and which calculated the tax on capital gains at the rate of 20%. For the period 2007/08, Mr Scott's return was filed electronically. Mr Scott's accountants again used software based on specifications and algorithms provided by HMRC that indicated, once again, that the relevant rate of tax on the capital gains would be 20%.

12. HMRC opened enquiries into the tax returns under section 9A of the Taxes Management Act 1970 ("TMA") for both periods. It closed its enquiries and issued closure notices for both periods on 13 February 2015. The closure notices show: in respect of the tax year 2006/07 income of £44.16 million and chargeable gains of £8.84 million; and in respect of the tax year 2007/08, income of £7.98 million and chargeable gains of £14.71 million. The closure notices, inter alia, challenged the proposition that the deductions claimed in respect of the insurance policies could reduce the rate of tax on chargeable gains from 40% to 20% and charged tax at the higher rate.

13. Mr Scott appealed to the Tribunal. The grounds of appeal in the notice of appeal were stated as follows:

> "The appeal relates to the rate of capital gains tax that should be applied to the Appellant's capital gains for the 2006/07 and 2007/08 tax years. In these years, the Appellant had claims for CDR under section 539 ITTOIA which exceeded both his income and capital gains. There is no dispute between the parties over the quantum of the capital gains or the amount of CDR. The sole dispute concerns how section 4 TCGA 1992 should determine the rate of tax to be charged on the gains. The Appellant claims that the capital gains should be charged at the 20% rate of capital gains tax. HMRC initially through their computer systems assessed the gains at 20%, but much later into their enquiries decided the gains should be assessed at the 40% rate. There is no factual dispute between the parties and the matter for the Tribunal is the statutory interpretation of section 4 after taking into account section 6(2) TCGA 1992. The

Appellant's chargeable gains for 2006/07 and 2007/08 were £8,844,541 and £14,713,593."

14. Mr Scott also sought to bring judicial review proceedings against HMRC to establish that, when HMRC had indicated that the relevant rate of tax was 20%, he had a legitimate expectation that that was the correct rate and that HMRC could not subsequently apply a higher rate. The written application was refused by Blair J on 6 July 2015. The oral application was heard by Irwin J in the High Court on 14 August 2015 and also rejected. In both cases, the application to bring judicial review proceedings was rejected principally on the grounds that that there had been no representation by HMRC sufficient to give rise to a legitimate expectation that tax would be charged on capital gains at a rate of 20%. Mr Scott did not appeal these decisions.

15. Mr Scott applied to the Tribunal to add a new ground to his grounds of appeal. The new ground was that, in summary, since the tax shown on the original returns had been calculated by HMRC itself at 20% of the relevant gains or inserted on the electronic return in reliance on indications from HMRC, HMRC could not "enquire" into its own calculations and recommendations under section 9A TMA.

16. The application was heard by the Tribunal (Judge Nowlan) on 19 February 2016. Judge Nowlan granted the application (*Scott v. HMRC* [2016] UKFTT 171).

THIS DECISION NOTICE

17. In this decision notice, I have dealt first with the substantive issue and then with the procedural issue.

18. The substantive issue arises in relation to the tax year 2006/07 and the tax year 2007/08. The parties agreed that the effect of the legislation in each of the two tax years should be the same except with respect to one issue (which I have referred to in this decision as the "gateway argument") which arises only in relation to the tax year 2007/08. However, given that the relevant legislation is not the same in the two tax years, I have dealt with the analysis for the two tax years separately.

19. As regards the procedural issue, as a preliminary point, Mr Pritchard, on behalf of HMRC, argued that the procedural issue was a matter for judicial review and that the Tribunal did not have the jurisdiction to determine the issue. I have accordingly dealt with the jurisdiction point prior to dealing with the procedural issue itself in this decision.

THE SUBSTANTIVE ISSUE: TAX YEAR 2006/07

The relevant legislation in the tax year 2006/07

20. For the tax year 2006/07, the rates of CGT were set out in section 4 of the Taxation of Chargeable Gains Act 1992 ("TCGA"). At the time, section 4 read, so far as relevant, as follows:

4. **Rates of capital gains tax**

(1) Subject to the provisions of this section, the rate of capital gains tax in respect of gains accruing to a person in a year of assessment shall be equivalent to the lower rate of income tax for the year.

(1AA) …

(1AB) If (after allowing for any deductions in accordance with the Income Tax Acts) an individual has no income for a year of assessment or his total income for the year is less than the starting rate limit, then -

(a) if the amount on which he is chargeable to capital gains tax does not exceed the unused part of his starting rate band, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the starting rate;

(b) if the amount on which he is chargeable to capital gains tax exceeds the unused part of his starting rate band, the rate of capital gains tax in respect of such gains accruing to him in the year as correspond to the unused part shall be equivalent to the starting rate.

(1AC) The references in subsection (1AB) above to the unused part of an individual's starting rate band are to the amount by which the starting rate limit exceeds his total income (as reduced by any deductions made in accordance with the Income Tax Acts).

(2) If income tax is chargeable at the higher rate or the dividend upper rate in respect of any part of the income of an individual for a year of assessment, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the higher rate.

(3) If no income tax is chargeable at the higher rate or the dividend upper rate in respect of the income of an individual for a year of assessment, but the amount on which he is chargeable to capital gains tax exceeds the unused part of his basic rate band, the rate of capital gains tax on the excess shall be equivalent to the higher rate of income tax for the year.

(4) The reference in subsection (3) above to the unused part of an individual's basic rate band is a reference to the amount by which the basic rate limit exceeds his total income (as reduced by any deductions made in accordance with the Income Tax Acts).

21. Section 6 TCGA dealt with the application of section 4 in certain special cases. In relation to CDR, it provided in section 6(2)(a):

6. **Other special cases**

(2) Where for any year of assessment -

(a) by virtue of section 539 of ITTOIA 2005 (gains from contracts for life insurance etc.) a deduction of an amount is made from a person's total income for the purposes of extra liability, or

(c) [….]

section 4(4) shall have effect as if his income for the year were reduced by that amount.

22. Section 6(2)(a) cross-referred to section 539 ITTOIA, which is the provision which gave effect to CDR for income tax purposes. In that year, section 539 was as follows:

539. **Relief for deficiencies**

(1) A deficiency from a policy or contract arising on a chargeable event is allowable as a deduction from an individual's total income for a tax year if, had a gain arisen instead on that event –

(a) the individual would have been liable to income tax on the gain for that year, or

(b) the individual would have been so liable apart from the requirement in section 465(1) that the individual must be UK resident in the tax year in which the gain arises.

(2) See section 540 for the cases in which such a deficiency is treated as arising, section 541 for how the deficiency is calculated and section 469(5) for the apportionment of deficiencies in cases where two or more persons are interested in a policy or contract.

(3) Subsection (1) only applies for the purpose of determining the individual’s extra liability.

(4) For this purpose, an individual’s extra liability is the amount by which the individual's liability to income tax exceeds the amount it would be on the assumptions specified in subsections (5) and (6).

(5) It is assumed that income charged to tax at the higher rate is charged –

(a) in the case of income within section 1A(1A)(c) of ICTA (income charged at the lower rate instead of the basic rate), at the lower rate, and

(b) in any other case, at the basic rate.

(6) It is assumed that income charged to tax at the dividend upper rate is charged at the dividend ordinary rate.

The parties’ arguments

23. In the course of the hearing, the parties put forward three different interpretations of the statutory provisions for the tax year 2006/07, each of which produces different results on the facts of this case.

24. Mr Firth, for Mr Scott, put forward a construction based on what he expressed to be a purposive interpretation of the provisions. I have referred to this construction as the "appellant's interpretation" in this decision.

25. Mr Pritchard, for HMRC, advanced two alternative constructions of the provisions: the first, his preferred interpretation, was referred to by the parties as the "negative income argument"; the second, was referred to by the parties as the "amount argument". I have adopted the parties' terminology in this decision.

26. I have set out the parties' arguments by reference to each interpretation in turn. I also heard submissions by both parties on general principles of statutory construction in the context of these provisions. I have dealt with these arguments primarily in the context of the appellant's interpretation.

The appellant's interpretation

27. Mr Firth, on behalf of Mr Scott, relied on the interpretation of these provisions that I have summarized at [29] below. For the reasons that I have set out below (see [33]), he gave his initial explanation by reference to the provisions of the Finance Act 1988 ("FA 1988") and the income tax provisions that were in force at the time and then applied the same logic to the provisions for the tax year 2006/07.

28. The relevant tax year is 2006/07 and so, in the summary below, I have used references to the legislation in the tax year 2006/07. I have, however, referred to the equivalent provisions in FA 1988 and the related income tax provisions in square brackets.) These provisions are set out in Appendix 2 to this decision notice.

29. In summary, the appellant's interpretation is as follows:

> (1) The "unused part of the individual's basic rate band" is defined in 4(4) [section 98(4)] as the amount by which the basic rate limit exceeds his or her total income for the year.
>
> (2) Where a person is entitled to CDR in calculating his or her liability to income tax, section 6(2)(a) TCGA [section 102(2)(b) FA 1988] provides that section 4(4) TCGA [section 98(4) FA 1988] shall have effect as if the taxpayer's income is reduced by an "amount".
>
> (3) That amount is the amount of the deduction made from that person's total income for the purposes of extra liability (i.e. the difference between tax at the higher rate and tax at the basic rate) under section 539 ITTOIA [section 549 Income and Corporation Taxes Act 1988 ("ICTA")].
>
> (4) Where a taxpayer is entitled to CDR, section 539(1) ITTOIA [section 549 ICTA] allows a deduction in computing total income for the full amount of "the deficiency" for the purposes of extra liability. So the deduction that is made from that person's total income for the purposes of extra liability is the full amount of CDR.

(5) It is this amount which is treated as reducing the total income of the taxpayer for the purposes of determining the unused part of the individual's basic rate band in section 4(4) [section 98(4)]. It does not matter that the individual's total income for these purposes might be a negative amount, it is simply an element in the overall calculation.

30. On the appellant's interpretation, the amount of the reduction to the individual's income required by section 6(2)(a) is the full amount of the deficiency. This reduction is applied even if the effect is to produce a negative figure for income that is used in calculating the "unused part of the basic rate band".

31. In a case where the individual's income becomes a negative figure, the effect is to extend the "unused part of the basic rate band" by that amount so that a greater amount of chargeable gains are potentially subject to tax at the lower rate. The result in relation to the chargeable gains accruing to Mr Scott in the tax year 2006/07 (and in 2007/08) is that gains falling within that (extended) basic rate band are taxed at the lower rate (20%).

32. For practical purposes, the overall effect is the same as extending the basic rate band by the amount of CDR which is available for the purposes of calculating the rate of CGT. The software which Mr Scott's accountants used for calculating the tax payable on his chargeable gains worked in this way.

Mr Scott's arguments

33. Mr Firth made the following points on behalf of Mr Scott.

(1) The purpose of the legislation which is contained in section 4 and section 6 TCGA is twofold: first, to align rates of income tax and CGT; and second, to tax capital gains as a marginal slice of income.

(2) This can be seen from the manner in which that legislation was originally enacted in section 98 and section 102 FA 1988. So far as relevant, section 4 TCGA is a direct transposition of section 98 FA 1988 and the relevant parts of section 6(2) TCGA are a direct transposition of section 102 FA 1988 subject to necessary changes to give effect to changes in cross-references to other legislation.

(3) Those purposes are the clear purposes of the words of the Act. There is no need to refer to any Parliamentary material such as Hansard in support of that interpretation. However, a reference to Hansard and in particular to the statement of the Chancellor of the Exchequer (Nigel Lawson) in his Budget Speech on 15 March 1988 (see [61] below) supports that view.

(4) Those purposes are achieved by plugging the relevant amounts into the simple formula that is specified in legislation. It does not matter if the effect of this interpretation is that "total income" in section 4(4) might be a negative number. That is only an element in the calculation.

(5) It is only this construction that produces results which are consistent with the purposes of the legislation namely to align income tax and CGT rates and to tax capital gains at marginal income tax rates. It is only this construction which ensures that the next £1 of income or capital gain arising to Mr Scott is taxed at the same rate.

(6) Once the purpose of the legislation has been identified, it is necessary to adopt the interpretation that is consistent with that purpose (in this respect Mr Firth refers to the judgments of Lord Reid in *Luke v Inland Revenue Commissioners* [1963] AC 557 at p576-p577, Lord Wilberforce in *Rank Xerox Ltd v Lane* [1981] AC 629 at p639C-H, and Scott LJ in *O'Rourke v Binks* [1992] STC 703 at p707f-p708a and p709d-g).

(7) The words of the legislation are clear. It is not necessary to refer to external material in order to discern the purpose of the legislation. External material is however admissible to show the context in which the statutory language is intended to operate and the mischief that it is intended to address (see in *Westminster City Council v National Asylum Support Service* [2002] 1 WLR 2956 per Lord Steyn at p2959A-F, *R v Secretary of State for the Environment, Transport and the Regions ex parte Spath Holme Ltd* [2001] 2 AC 349 per Lord Bingham at p391D-p392D). The statement of the Chancellor of the Exchequer on 15 March 1988 is therefore admissible as evidence of the context in which the legislation was made, namely the differential rates of tax on income and capital gains that existed prior to FA 1988, and the mischief that the legislation was intended to address, namely the distortion of incentives to which differential rates of tax on income and capital gains are said to give rise.

(8) The Chancellor's statement is only admissible to demonstrate the purpose of the legislation if the criteria set out by the House of Lords in *Pepper v Hart* [1993] AC 593 are met. But the purpose of the statutory language is clear. It would only be if the wording was ambiguous or produced an absurd result that it would be permissible to refer to Hansard. It is only HMRC's arguments that produce absurd results.

HMRC's arguments

34. Mr Pritchard made the following points on behalf of HMRC.

(1) HMRC do not agree that the purpose of the legislation is to align rates and tax gains as a marginal slice of income.

(2) Mr Scott's approach to statutory interpretation is wrong. Mr Scott's arguments attempt to identify a purpose for the legislation and then fit the words of the statute to that purpose. The correct approach is to identify the purpose from the words of the statute.

(3) The purpose of section 4 and section 6 TCGA is much more limited. The purpose of section 4 is to calculate the unused part of the basic rate band in order to determine the rate of CGT which is applicable. The purpose of section 6 is to define income for the purposes of section 4(4).

(4) The logical consequence of the appellant's interpretation is that income and gains should be amalgamated, but that is not what the statute does. The statute calculates income and gains independently and then amalgamates them for the purposes of determining the rates. The effect of the appellant's interpretation is to transform CDR into a relief from CGT. It is a relief from income tax.

(5) The statement made by the Chancellor in his Budget Speech in March 1988 does not assist Mr Scott. There is no suggestion in the statement that the effect will be to apply income tax reliefs to CGT. The statement is a general statement about fairness and rates of tax. It does not identify the purpose of the legislation.

(6) In any event, it is not permissible to use the statement in Hansard as evidence of the purpose of the legislation. It is only permissible to do so if the words of the legislation are ambiguous or give an absurd result. The negative income argument (see below) is not an absurd result.

(7) Even if the words were ambiguous, the statement could not be taken into account to assist interpretation. The statement does not meet the criteria set out in *Pepper v. Hart*. It is not directed at the words of the statute. Furthermore, the policy and objects should be determined by construing the legislation. The policy and objects should not be derived from the purpose or intention of the executive.

The negative income argument

35. Although in his skeleton argument Mr Pritchard had preferred the "amount argument" (see below), at the hearing, he advanced the negative income argument as his preferred interpretation of the legislation.

36. In summary, the negative income argument is as follows:

(1) When a person is entitled to CDR in computing his or her liability to income tax, the "amount" by which the person's income can be reduced under section 6(2)(a) TCGA for the purposes of section 4(4) TCGA is the amount of the deduction made under section 539 ITTOIA.

(2) However, that deduction can only reduce income to nil. It cannot reduce income to a negative number for the purposes of section 4(4).

(3) The effect is that the "unused part of the basic rate band" in section 4(4) TCGA cannot be more than the whole of the basic rate band.

37. On the negative income argument, the total income of an individual can only be reduced under section 6(2) to nil and no further; and the maximum amount of chargeable gains that can be taxed at the lower rate as a result of the application of section 6(2) is the amount of the basic rate band.

HMRC's arguments

38. In support of the negative income argument, Mr Pritchard made the following points:

(1) The amount of the deduction that is required by virtue of section 6(2)(a) is an amount equal to the deduction that is "made" from total income for the purposes of computing extra liability under section 539 ITTOIA.

(2) The only deduction that can be made is a deduction in an amount which reduces total income to nil. It is not possible to create a negative amount of total income. In this respect, Mr Pritchard referred to a passage in the judgment of Warren J in *HMRC v. Martin* [2014] UKUT 429 (TCC) at [35].

(3) Furthermore, the consequence of the appellant's interpretation is that the unused part of the basic rate band can be more than the whole of the basic rate band. The reference to the "unused part" makes it clear that the part cannot be more than the whole. The legislation does not extend the basic rate band. This should be contrasted with the legislation in relation to gift aid where the basic rate band is expressly extended (see section 414(2) of the Income Tax Act 2007 ("ITA")).

(4) Parliament uses the word "income". As a general matter income cannot be negative.

(5) The legislation uses a real world concept of income. It is not an element in a formula. Where section 4(4) refers to "total income" it is referring to the amount on which the taxpayer pays tax.

(6) As a general rule, when legislation refers to income, it is implicit that income is not negative. This can be seen from the Explanatory Notes for ITA at paragraphs [110] and [124].

Mr Scott's arguments

39. In response to the negative income argument, Mr Firth relied for the most part on his interpretation of the legislation and in particular to his point that only on his construction is Mr Scott taxed at the same rate on the next £1 of gain or income that accrues to him. He also made the following specific points.

(1) He reiterated his point that section 4 and section 6 of TCGA provide a simple formula. When section 6(2) requires income to be reduced by a certain amount for the purposes of 4(4), there is no requirement that the result of that calculation has the character of "income". It is simply an element in the calculation, which is then used in section 4. It is not a "real world" figure for income.

(2) In any event, income can be negative. Mr Firth referred to the decision of Warren J in *HMRC v Martin* in support of this submission.

(3) If Parliament had intended that the result of the calculation required by section 4(4) could not be negative, it would have said so. Mr Firth gave numerous examples of provisions in which it is expressly provided that a given figure cannot be negative (see, for example, section 75B ICTA, section 234 TCGA, section 122, section 127, section 131, section 133 Finance Act 2004 and section 142D ITTOIA).

The amount argument

40. In the event that the Tribunal did not accept negative income argument, Mr Pritchard raised an alternative interpretation of the legislation. This is the amount argument.

41. The amount argument is as follows:

(1) Section 6(2)(a) requires a taxpayer's income for the purposes of section 4(4) to be reduced by an amount.

(2) The amount of the reduction is the amount of the deduction that is "made" under section 539 ITTIOA.

(3) Under section 539, the deduction is only made for the purpose of determining the taxpayer's "extra liability" (see section 539(3)). The extra liability is the amount by which the individual's liabilities to tax exceed the amount of tax which would have been payable if all dividends had been taxed at the dividend ordinary rate and all other income had been taxed at the lower rate or the basic rate.

42. The amount of the deduction required by section 6(2)(a) is therefore the amount which reduces the individual's total income to the basic rate threshold. No further deduction is "made" under section 539.

43. On this argument, therefore, the deduction is limited to an amount required to reduce the individual's income to the basic rate threshold. If this interpretation is correct, a claim for CDR does not affect the rate at which CGT is charged on the individual's capital gains.

HMRC's arguments

44. In support of this argument, Mr Pritchard made the following specific points.

(1) On the wording of the legislation, section 539 only applies for the purpose of determining an individual's extra liability. The only deduction that needs to be made for the purpose of determining an individual's extra liability is a deduction that reduces the individual's total income to the amount of the basic rate threshold. No further deduction is required.

(2) In anticipation of Mr Firth's argument (see below) this interpretation does not deprive section 6(2) of effect. It simply identifies that a claim for CDR has no bearing on the calculation in section 4(4) and so does not affect the rate at which CGT is charged.

Mr Scott's arguments

45. Mr Firth said that the amount argument is wrong. He relied once again, in principle, on his interpretation of the legislation. He also made the following specific points.

(1) Section 539(1) allows as a deduction the amount of the deficiency. It provides that the full amount of the deficiency can be deducted. Section 539(3) which provides that CDR only applies for the purpose of calculating extra liability, sets out the purpose of the deduction. It does not determine the amount of the relief.

(2) The effect of the amount argument is to nullify the effect of section 6(2)(a). Section 6(2)(a) requires that an amount be deducted from a person's income for the purpose of section 4(4). It does not say that no account shall be taken of a claim for CDR.

(3) It is an accepted principle of statutory interpretation that Parliament does not legislation in vain. In support of this submission, Mr Firth referred, in particular to *Halki Shipping Corp v Sopex Oils Limited* [1998] 2 All ER 23 and *Boyle v Secretary of State for Northern Ireland* [2010] NICA 5.

Discussion

46. For the tax year 2006/07, section 4 TCGA set out the rates at which CGT was charged on gains accruing to an individual.

The scheme of the legislation

47. The broad scheme of the rate structure is evident from the structure of section 4. In very broad terms, the amount which is subject to CGT was calculated (after giving effect to relevant losses, reliefs and allowances); that amount was then added to the total income of the individual as calculated for income tax purposes and taxed at the rate that would have applied if it had been additional income.

48. The manner in which this rate structure is achieved in section 4 is perhaps not the most straight-forward.

49. The default position is that the amount which is subject to CGT is taxed at the lower rate of income tax (sub-section (1)), which in the tax year 2006/07 was 20%. Section 4 then provides a series of exceptions from this default position. In summary:

(1) if an individual had no income or the individual's total income was less than the "starting rate limit" (as defined in section 832 ICTA), the amount

which was subject to CGT was taxed at the starting rate (10%, in the tax year 2006/07) up to the amount of the starting rate limit (sub-section (1AB));

(2) if an individual had income which was taxed at the higher rate or the dividend upper rate, the entire amount which was subject to CGT was subject to tax at the higher rate (40% in the tax year 2006/07) (sub-section (2)); and

(3) if an individual had no income which was taxed at the higher rate or the dividend upper rate, but the amount which was subject to CGT exceeded "the unused part" of the individual's basic rate band, the excess was subject to tax at the higher rate (sub-section (3)).

50. The "unused part" of an individual's basic rate band is then defined in sub-section (4) as the amount by which the basic rate limit exceeds the individual's total income for income tax purposes (which is in turn defined in section 832(1) ICTA).

51. If we ignore for present purposes the provisions dealing with the application of the starting rate, and before we turn to the provisions which deal with CDR, the effect of these provisions was therefore, in broad terms, that the amount subject to CGT was added to total income and to the extent that the amount exceeded the basic rate limit taxed at the higher rate and to the extent that it fell within it taxed at the lower rate.

52. Section 6(2) dealt with "special cases". One such special case was where the individual had claimed CDR.

53. In the tax year 2006/07, section 539(1) ITTOIA provided that the way in which CDR was given was by allowing a deduction for the deficiency from the individual's total income. That deduction was, however, only made for the purposes of determining an individual's "extra liability", that is the individual's liabilities to income tax at rates above the basic rate or the dividend ordinary rate (in accordance with section 539(3) ITTOIA).

54. Section 539 therefore appears to contemplate two calculations of "total income": one for the purposes of determining an individual's liability to higher rates of tax, from which a deduction is made for the deficiency; and the other for the purpose of determining an individual's liability to tax at other rates from which no deduction was made. Relief is then given by comparing the income tax payable as a result of these two calculations (as explained in the Explanatory Notes to ITA (see [108] below)).

55. In a case where CDR had been claimed, section 6(2) provided that section 4(4) was to have effect as if the individual's income was reduced by an amount, that amount being the amount of the deduction "made from a person's total income for the purposes of determining an individual's extra liability".

56. The argument on the substantive issue in the tax year 2006/07 has revolved around two issues concerning the interpretation of section 6(2):

(1) the "amount" of the deduction that "is made" in accordance with section 539 ITTOIA; and

(2) whether, when an individual's income is reduced by that amount, the result can be a negative amount for the purposes of determining the unused part of the individual's basic rate band in section 4(4).

57. On the appellant's interpretation, the amount of the deduction that is made is the amount of the deficiency; and income can be reduced to a negative amount. On the negative income argument, the amount of the deduction that is made may or may not be the amount of the deficiency, but income cannot be reduced to a negative amount. On the amount argument, the amount of the deduction that is made is the amount required to reduce the individual's income to the basic rate limit and income can never therefore be reduced to a negative amount.

Principles of statutory interpretation

58. These are questions of statutory interpretation, which is primarily an exercise in construing the words used in the statute in their context. As Lord Nicholls put it *R v Secretary of State for the Environment, Transport and the Regions ex parte Spath Holme Ltd* [2001] 2 AC 349 at page 396F:

> "Statutory interpretation is an exercise which requires the court to identify the meaning borne by the words in question in the particular context. The task of the court is often said to be to ascertain the intention of Parliament expressed in the language under consideration. This is correct and may be helpful, so long as it is remembered that the "intention of Parliament" is an objective concept, not subjective. The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draughtsman, or of individual members or even of a majority of individual members of either House. These individuals will often have widely varying intentions. Their understanding of the legislation and the words used may be impressively complete or woefully inadequate. Thus, when courts say that such-and-such a meaning "cannot be what Parliament intended", they are saying only that the words under consideration cannot reasonably be taken as used by Parliament with that meaning. As Lord Reid said in *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591, 613: "We often say that we are looking for the intention of Parliament, but that is not quite accurate. We are seeking the meaning of the words which Parliament used.""

59. I have been referred to various authorities on the principles that I should take into account in construing the words of the statute. I do not intend to set them out in full in this decision. I should, however, deal specifically the relevance of the external materials and, in particular, statements made in Hansard to which the parties have referred.

Relevance of the Chancellor's Statement on 15 March 1988

60. The particular statements to which the parties have referred are taken from the Budget Speech of the Chancellor of the Exchequer (Nigel Lawson) in Parliament on 15 March 1988 when announcing the measures dealing with CGT rates which became section 98 and section 102 FA 1988.

61. The relevant passages are as follows:

> "Moreover, at present, with capital gains taxed at 30% for everybody, higher rate taxpayers face a lower – sometimes much lower – rate of tax on gains than on investment income, while basic rate taxpayers face a higher rate of tax on gains than on income. This contrast is hard to justify.
>
> I therefore propose a fundamental reform. Subject to the new base date, capital gains will continue to be worked out as now, with the present exemptions and reliefs. But the indexed gain will be taxed at the income tax rate that would apply if it were the taxpayer's marginal slice of income. In other words, I propose in future to apply the same rate of tax to income and capital gains alike.
>
> These changes will not take effect until 6 April.
>
> Taxing capital gains at income tax rates makes for greater neutrality in the tax system. It is what we do now for companies. And it is also the practice in the United States, with the big difference that there they have neither indexation relief nor a separate capital gains tax threshold.
>
> The changes I have announced represent a thorough going reform of capital gains tax which will benefit the economy and eradicate a major injustice. They will sharply reduce the damaging effects of the tax, while ensuring that capital gains remain properly taxed and the yield of income tax adequately protected. They are expected to cost a little over £200,000,000 in 1989-90."
>
> (HC Deb, 15 March 1988, vol 129 cc1005-6)

62. Mr Firth suggested that these statements were admissible in providing context for the legislation, namely the differential rates of income tax and CGT which were in place at the time, and in identifying the mischief at which the legislation was aimed, namely the distortion of incentives created by those differential rates.

63. It seems clear from the authorities that it is permissible to rely on external materials to provide context for the legislation and to identify the mischief at which it is aimed. When used for this purpose, there is no particular reason for treating statements made in Hansard any differently from other relevant materials. The position is summarized by Lord Steyn in *R (Westminster City Council) v National Asylum Support Service* (admittedly obiter) in the context of a reference to Explanatory Notes where he said (at page 2958E):

> "The question is whether in aid of the interpretation of a statute the court may take into account the Explanatory Notes and, if so, to what extent. The starting point is that language in all legal texts conveys meaning according to the circumstances in which it

was used. It follows that the context must always be identified and considered before the process of construction or during it. It is therefore wrong to say that the court may only resort to evidence of the contextual scene when an ambiguity has arisen. In regard to contractual interpretation this was made clear by Lord Wilberforce in *Prenn v Simmonds* [1971] WLR 1381, 1384-1386, and in *Reardon Smith Line Ltd v Yngvar (trading as H E Hansen-Tangen)* [1976] WLR 989, 995-996. Moreover, in his important judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1WLR 896, 912-913 Lord Hoffmann made crystal clear that an ambiguity need not be established before the surrounding circumstances may be taken into account. The same applies to statutory construction."

He then cited the judgment of Lord Blackburn in *River Wear Comrs v Adamson* (1877) 2 App Cas 743 and continued:

"Again, there is no need to establish an ambiguity before taking into account the objective circumstances to which the language relates. Applied to the subject under consideration the result is as follows. In so far as the Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible aids to construction. They may be admitted for what logical value they have. Used for this purpose Explanatory Notes will sometimes be more informative and valuable than reports of the Law Commission or advisory committees, Government green or white papers, and the like. After all, the connection of Explanatory Notes with the shape of the proposed legislation is closer than pre-parliamentary aids which in principle are already treated as admissible: see *Cross, Statutory Interpretation*, 3rd ed (1995), pp 160-161. If used for this purpose the recent reservations in dicta in the House of Lords about the use of Hansard materials in aid of construction are not engaged: see *R v Secretary of State for the Environment, Transport and the Regions, Ex p Spath Holme Ltd* [2001] 2 AC 349 , 407; *Robinson v Secretary of State for Northern Ireland* The Times, 26 July 2002 , in particular per Lord Hoffmann, at para 40.".

64. I have had regard to the statements made by the Chancellor for those purposes, although the context is evident from the changes made by the legislation itself.

65. What is important, however, is not to treat the statements of the Government or a minister sponsoring the legislation as reflecting the intention of Parliament. As Lord Cook put it in *Spath Holme* (at page 407G-H):

"In my opinion there are sound reasons of principle for rejecting the argument that statements made by ministers in Parliament may be used to identify the policy and objects of an enactment for the purpose of identifying the scope of a discretionary power which Parliament has conferred on the executive. As Lord Reid made clear in *Padfield v Minister of Agriculture, Fisheries and Food* [1968] AC 997, 1030b-c, the policy and objects of the Act must be determined by construing the Act. The underlying rule is that it is the intention of Parliament that defines the policy and objects of the Act, not the purpose or intention of the executive. The law-making function belongs to Parliament, not to the executive."

66. There are statements to similar effect in other cases; see, for example, the judgment of Lord Steyn in the *National Asylum Support Service* case (at page 2959F) and the judgment of Lord Nicholls in *Spath Holme* (to which I referred at [58] above).

67. Mr Firth went on to say that the statement made by the Chancellor is not admissible for determining the purpose of the legislation unless the ordinary meaning of the words is ambiguous or obscure or produces an absurd result. Here he referred to the decision of the House of Lords in *Pepper v Hart* and to the circumstances in which, as an exception to usual prohibition of the use of Parliamentary material as an aide to statutory construction. I was referred in particular to the judgment of Lord Browne-Wilkinson at page 640C where he said:

> "I therefore reach the conclusion, subject to any question of Parliamentary privilege, that the exclusionary rule should be relaxed so as to permit reference to Parliamentary materials where (a) legislation is ambiguous or obscure, or leads to an absurdity; (b) the material relied upon consists of one or more statements by a Minister or other promoter of the Bill together if necessary with such other Parliamentary material as is necessary to understand such statements and their effect; (c) the statements relied upon are clear.
>
> Further than this, I would not at present go."

68. Mr Pritchard in essence agreed with that point, but argued that the statements made by the Chancellor would not meet the *Pepper v Hart* criteria because they are not directed at the words of the statute and not sufficiently clear.

69. I agree with Mr Pritchard. In my reasoning below I have not resorted to the Chancellor's statement in order to determine the purpose of the legislation. The Chancellor's statement is made as part of his Budget Speech and without reference to the words of the legislation. It may reflect a broad statement of the Government's intention but it is not indicative of the intention of Parliament as expressed in the words of the statute. In any event, as I have mentioned below, the broad scheme of the legislation is clear from the words of the statute. The difficulty in interpretation arises in relation to the particular provisions relating to CDR. The Chancellor's statement says nothing about the interaction of the legislation relating to CGT rates and CDR.

The amount of the deduction that "is made" in accordance with section 539 ITTOIA

70. Section 6(2)(a) refers to the amount of the deduction which "is made" from a person's total income for the purposes of determining the person's extra liability by virtue of section 539(1) ITTOIA.

71. Section 539(1) ITTOIA confirms that the deficiency is "allowable" as a deduction. Section 539(3) tells us that subsection (1) only applies for the purposes of determining the individual's extra liability, but there is nothing in subsection (3) or the remainder of section 539 which determines the extent to which the amount that is allowable is to be treated as "made".

72. Mr Firth argued the point by reference to the legislation that was in place when the relevant CGT provisions were enacted in FA 1988. Section 102(2)(b) FA 1988 is in much the same terms as the relevant parts of section 6(2)(a), although it referred to the deduction that was made by virtue of section 549 ICTA (which at the time contained the legislation relating to CDR). Section 549(1) ICTA referred to the

deficiency being "allowable" as a deduction in much the same way section 539(1) ITTOIA. However, section 549(2) which set out the purpose for which the deduction was made was in different form to section 539(3) ITTOIA. It provided that the deduction which was "allowable" under section 549(1) "shall be made". Mr Firth says that Parliament did not intend to change the law when it introduced ITTOIA. So, Mr Firth says, the wording of Section 549 clearly supports his case that the amount of deduction that is made under section 6(2)(a) is the full amount of the deficiency.

73. ITTOIA was enacted as part of the Tax Law Rewrite Project. The parties accepted that the changes made by ITTOIA were not intended to change the effect of the relevant provisions. I acknowledge that there is no reference in the supporting materials, in particular the Explanatory Note that accompanied ITTOIA, to suggest that there was any intention that the form of section 539 ITTOIA would result in a change in the law. However, I think that the correct approach is to treat ITTOIA in the same way as other consolidating legislation: as a single integrated body of law, without any need for reference back to the provisions as they appeared in earlier statutes unless the provision in the consolidating legislation is found to be ambiguous or there is a real and substantial difficulty in interpreting the legislation using the normal canons of construction. There is support for that approach in the judgment of Sales J in *Eclipse Film Partners (No.35) LLP v. HMRC* [2013] UKUT (TCC) 639 at paragraph 97 and the decision of the Upper Tribunal (Judge Herrington and Judge Scott) in *Scambler v. HMRC* [2017] UKUT 0001 (TCC) at [47] (to which I was not referred by the parties).

74. That having been said, the wording of the legislation does not give rise to a material difficulty on this point. Section 539(1) clearly states that the full amount of the deficiency is allowable as a deduction. While section 539(3) defines the purpose for which the deduction is made, it does not determine the amount of the deduction. So absent any other restriction, the full amount of the deduction is potentially available as a deduction from income for the purpose of calculating liability to tax at higher rates.

75. At this point, it is convenient to refer back to the amount argument.

76. By way of recap, the amount argument is that the amount of the deduction required by section 6(2)(a) TCGA is limited to the amount required to reduce the total income of the taxpayer to the amount of the basic rate limit. This argument relies on the provisions of section 539(3) ITTOIA. In essence, HMRC say that the deduction which is allowed to be made by section 539(1) ITTOIA is the amount which is allowed for the purposes of determining liability at higher rates. So the only deduction that needs to be made is the amount that is required to reduce the individual's total income to the level of the basic rate limit. Any further deduction is unnecessary. It is only a deduction in this amount that is actually made under section 539(1) and so it is only this amount that has to be deducted from an individual's total income for the purposes of section 4(4) as required by section 6(2)(a).

77. I have rejected the amount argument. To my mind, it places too much weight on section 539(3). As I mentioned at [71] above, section 539(3) defines the purpose for which the deduction is made. It does not determine the amount of the deduction.

78. In doing so, I have also taken into account the following points:

(1) Section 539(1) ITTOIA (and its predecessor in section 549 ICTA) provides for CDR to be given by reference to a calculation of "total income". The calculation of total income takes place logically prior to application of the basic rate limit and not by reference to it.

(2) The argument deprives CDR of any effect on CGT rates. It is hard to see that this is the intended effect of section 6(2). If the amount of the deduction is limited to the amount that reduces the total income of the individual to the basic rate limit, the calculation in section 4(4) is never affected by any deduction required by section 6(2). The argument renders the final words of section 6(2) superfluous. If that was the intended effect, the provision could simply have said that no account should be taken of CDR in determining CGT rates, it would not have required an amount to be deducted in the calculation in section 4(4). In this respect, I agree with Mr Firth.

79. On that basis, I conclude that the amount of the deduction referred to in section 6(2)(a) can be the full amount of the deficiency.

Can income be reduced to a negative amount for the purposes of determining the unused part of the basic rate band?

80. That is not however, the end of the matter. The question is then, even if the full amount of the deficiency is potentially allowed as a deduction, whether when that deduction is applied to reduce an individual's income, the result can be a negative amount for the purposes of determining the unused part of the basic rate band for the purposes of section 4(4) TCGA. This brings us to the negative income argument.

81. HMRC says that it is implicit that the calculation required by section 6(2) cannot produce a negative answer. Income cannot be negative and so the calculation in section 6(2) cannot reduce total income beyond zero.

82. In support of this submission, Mr Pritchard says that the general presumption is that income must be a positive number. He refers to the definition of income in the Oxford English Dictionary. He also refers to statements in the Explanatory Notes to ITA where it is stated:

> "Some, but not all, of the source provisions contained the rule that income cannot be reduced below nil, but even where not explicitly mentioned, it has always been the accepted practice that the deduction can only be made from income to the extent that there is income to absorb the deduction. The position is now explicit for all income deductions." [Paragraph 110 Chapter 3 Part 2 Explanatory Notes.]

83. Mr Pritchard also referred to the decision of Warren J in *HMRC v Martin* [2014] UKUT 429. In that case, Warren J dismissed an appeal by HMRC against a decision of the First-tier Tribunal ("FTT") that a payment made by Mr Martin by way of a clawback of a signing on bonus could be regarded as negative taxable earnings for the purposes of section 11 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"). However, Mr Pritchard pointed to a passage in the decision of Warren J (at [35]) where, in the context of the formula in section 11(1) ITEPA which defines net taxable earnings, he suggested that it was not possible to reduce a negative number further.

84. Mr Firth says that section 6(2) is just a formula, namely income less the amount of the deficiency. It does not matter that the outcome of that formula might be negative. Section 6(2) is not trying to define income in any real sense. It is just an element in the calculation.

85. In any event, Mr Firth says that there is nothing to say that income cannot be negative. He too points to passages from the decision of Warren J in *HMRC v Martin*, where Warren J accepts that, although his immediate inclination might have been that "taxable earnings" could not be negative, in the context of the legislation and the contractual provisions with which he was dealing, it was permissible for the concept of taxable earnings to be negative in circumstances where the relevant payments would have been regarded as negative emoluments under the previous legislation. I refer in particular to paragraphs [31] to [37] and [44] to [47].

86. Mr Firth therefore says that there can be no presumption that income must be positive. He also refers to various provisions in the tax legislation (including those to which I refer at [39] above) where it is specifically provided that the result of a particular formula cannot be negative. He says that if Parliament had intended that the result of the formula in section 6(2) could not be negative, it would have said so.

87. For my own part, I do not take any principle of general application from the decision in *HMRC v. Martin*. As Warren J makes clear (at [81]), the decision itself is very much to be seen in the context of the legislation and in the context of the particular contractual provisions which are the subject matter of the case. What I do take from that case is that whether or not a particular concept can be negative is to be taken from the context of the legislation itself. What I must do therefore is, in the context of this legislation, to determine whether the result of the income of the taxpayer as reduced by the amount of the deduction that is made for CDR (as required by section 6(2)) can be negative.

88. I have come to the conclusion that it cannot.

89. The scheme of the legislation is to take total income for income tax purposes after taking into account all relevant reliefs and allowances that apply to income tax and then to apply the income tax rates. The CGT provisions then operate after the application of the income tax provisions. The amount which is subject to CGT, after taking into account all relevant CGT reliefs and allowances, is added to the total income and the relevant rates are applied under section 4.

90. In my view, for the reasons that I have set out below, that scheme contemplates the addition of positive amounts (or at least not negative amounts) of income and capital gains.

91. As an initial point, the "income" of a person that is referred to in the final words of section 6(2) is the "total income" of that person as referred to in section 4(4). Total income is the amount of income on which an individual pays income tax and by implication cannot be negative.

92. That interpretation, in my view, is supported by the wording of section 4(4) which refers to the "unused part" of the basic rate band being "the amount by which an individual's basic rate limit exceeds total income". If Mr Firth's interpretation is correct and total income after the application of section 6(2) can be negative, the effect is that the "unused part of the basic rate limit" can exceed the amount of the actual basic rate band itself. Once again, that is not a natural reading and there is nothing in the remainder of the provisions of the Act to support it.

93. Many of the examples that Mr Firth put to the Tribunal in the course of argument showed the effect of CDR as if it operated as an extension of the basic rate band. Mr Firth says that this extension of the basic rate band is consistent with the way in which calculations for the application of CDR have been performed by HMRC. That is not the way in which the legislation governing CDR works. The relevant CDR provisions – in section 539 ITTOIA - require a comparison of liabilities arising on a calculation of total income for the purposes of basic rate liability and separate calculation of total income for the purposes of liability at higher rates on different assumptions. A calculation performed simply by extending the basic rate limit by the amount of CDR may provide a suitable short-cut to the amount of the resulting income tax liability in most cases. But it does not reflect the manner in which the relief is given on the terms of the legislation.

94. Furthermore, if that approach is extended to the provisions governing rates of CGT, the effect is to give relief for an income tax relief to reduce tax on capital gains. That would be a major step and I cannot discern such a broad purpose from the scheme of the Act. As Mr Pritchard pointed out, the legislation does not provide for a perfect integration of income tax and CGT. If it were to be so, the legislation would allow for reliefs from income tax to reduce capital gains and vice versa. It does not do that.

95. In the context of CDR, Mr Firth says that his is the only interpretation that gives full effect to the purpose of the legislation, namely to tax capital gains at the same marginal rate. It is the only interpretation on which the next £1 of income or £1 of gain will be taxed in the same way. But that is not the case for income or gains which might otherwise be absorbed by unused losses or reliefs taken into account in computing total income or the amount which is subject to CGT. There no reason to make a special case for CDR being available to reduce tax on capital gains.

96. In my view, the purpose of section 6(2) is more limited. It is not to turn an income tax relief into a relief which can be used to reduce CGT. The aims of section

6(2) are to identify the calculation of total income that is relevant (given that there are two possible calculations) and to ensure that the effect of section 4 does not deprive the taxpayer of the benefit of the basic rate threshold in a case in which CDR is claimed. Without section 6(2), if the amount of CDR exceeds the amount of income which is subject to tax at higher rates, then capital gains would potentially be taxed at higher rates even if there would have been additional capacity within the basic rate threshold.

97. Mr Firth can rightly say that all that this is doing is ensuring that the next £1 of gain is taxed in the same way as the next £1 of income up to the amount of the basic rate limit. That is true, but to my mind the extension of the argument to, in effect, convert an income tax relief into a relief from CGT goes beyond the natural meaning of the words.

98. Nor do I think that this is an absurd result. The effect is to preserve the benefit of the basic rate limit in a case where CDR applies. Without it, the taxpayer could effectively lose the benefit of the basic rate limit. The basic rate limit is an integral part of the rate structure and these provisions are about tax rates.

Conclusion

99. For the reasons that I have given above, in my view, the amount of the deduction that "is made" in section 6(2)(a) can be the amount of CDR. However, when that deduction is applied to reduce the income of the taxpayer as required by the final words of section 6(2), it cannot reduce the income of the taxpayer below nil. In summary, I agree with the "negative income argument".

THE SUBSTANTIVE ISSUE: TAX YEAR 2007/08

The relevant legislation in the tax year 2007/08

100. For the tax year 2007/08, various changes were made to the relevant legislation to take into account the introduction of ITA.

101. Following those changes, section 4 TCGA read as follows:

> 4. **Rates of capital gains tax**
>
> (1) Subject to the provisions of this section, the rate of capital gains tax in respect of gains accruing to a person in a year of assessment shall be equivalent to the savings rate] of income tax for the year.
>
> (1AA) ….
>
> (1AB) If an individual has no Step 3 income for a year of assessment or the individual's Step 3 income for the year is less than the starting rate limit, then -
>
> > (a) if the amount on which he is chargeable to capital gains tax does not exceed the unused part of his starting rate band, the rate of capital gains tax in

respect of gains accruing to him in the year shall be equivalent to the starting rate;

(b) if the amount on which he is chargeable to capital gains tax exceeds the unused part of his starting rate band, the rate of capital gains tax in respect of such gains accruing to him in the year as correspond to the unused part shall be equivalent to the starting rate.

(1AC) The references in subsection (1AB) above to the unused part of an individual's starting rate band are to the amount by which the starting rate limit exceeds the individual's Step 3 income.

(2) If income tax is chargeable at the higher rate or the dividend upper rate in respect of any part of the income of an individual for a year of assessment, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the higher rate.

(3) If no income tax is chargeable at the higher rate or the dividend upper rate in respect of the income of an individual for a year of assessment, but the amount on which he is chargeable to capital gains tax exceeds the unused part of his basic rate band, the rate of capital gains tax on the excess shall be equivalent to the higher rate of income tax for the year.

(4) The reference in subsection (3) above to the unused part of an individual's basic rate band is a reference to the amount by which the basic rate limit exceeds the individual's Step 3 income.

(5) For the purposes of this section the “Step 3 income” of an individual means the individual's net income less allowances deducted at Step 3 of the calculation in section 23 of ITA 2007 for the purpose of calculating the individual's income tax liability.

(6) Section 989 of ITA 2007 (the definitions) applies for the purposes of this section as it applies for income tax purposes.

102. Section 6 TCGA read as follows (so far as relevant):

6. **Other special cases**

(2) Where for any year of assessment -

(a) by virtue of 539 of ITTOIA 2005 (gains from contracts for life insurance etc.) a person is entitled to relief by reference to the amount of a deficiency, or

(c) …

section 4(4) shall have effect as if the person’s Step 3 income for the year were reduced by the amount of the deficiency …

(3) Where by virtue of section 465 of ITTOIA 2005 (gains from contracts for life insurance etc.) a person's total income for a year of assessment is deemed to include any amount or amounts -

(a) section 4(4) shall have effect as if the person's Step 3 income included not the whole of the amount or amounts concerned but only the annual equivalent within the meaning of section 536(1) of that Act or (as the case may be) the total annual equivalent within the meaning of section 537 of that Act, and

(b) if relief is given under section 535 of that Act and the calculation under section 536(1) of that Act or (as the case may be) section 537 of that Act does not involve the higher rate of income tax, section 4(2) and (3) shall have effect as if no income tax were chargeable at the higher rate or the dividend upper rate in respect of his income.

103. And section 539 ITTOIA read as follows:

539. **Relief for deficiencies**

(1) An individual is entitled to a tax reduction for a tax year in which a deficiency arises from a policy or contract on a chargeable event if -

(a) the condition in subsection (2) is met,

(b) the individual would (apart from this section) be liable to income tax at the higher rate or the dividend upper rate (or both) for the tax year, and

(c) the individual makes a claim.

(2) The condition is that, if a gain had arisen instead on the chargeable event-

(a) the individual would have been liable to income tax on the gain for the year, or

(b) the individual would have been so liable apart from the requirement in section 465(1) that the individual must be UK resident in the tax year in which the gain arises.

(3) The tax reduction is given effect at Step 6 of the calculation in section 23 of ITA 2007.

(4) See section 540 for the cases in which a deficiency is treated as arising from a policy or contract on a chargeable event, section 541 for how the deficiency is calculated and section 469(5) for the apportionment of deficiencies in cases where two or more persons are interested in a policy or contract.

(5) The amount of the tax reduction is calculated as follows.

Step 1
Attribute to the amount of the deficiency an amount of the individual's income for the tax year which is liable at the dividend upper rate, so far as is possible.

Step 2

If there is an amount of the deficiency remaining after Step 1, attribute to the remaining amount of the deficiency an amount of the individual's savings income for the tax year which is liable at the higher rate, so far as is possible.

Step 3
If there is an amount of the deficiency remaining after Step 2, attribute to the remaining amount of the deficiency an amount of the individual's other income for the tax year which is liable at the higher rate, so far as is possible.

Step 4
Calculate the amount of the individual's preliminary income tax liability for the tax year (see subsection (6)).

Step 5
Calculate the amount of the individual's preliminary income tax liability for the tax year again, on these assumptions–

Assume that any income attributed to the deficiency at Step 1 is liable at the dividend ordinary rate.

Assume that any income attributed to the deficiency at Step 2 is liable at the savings rate.

Assume that any income attributed to the deficiency at Step 3 is liable at the basic rate.

Step 6
Deduct the amount found at Step 5 from the amount found at Step 4.
The result is the amount of the tax reduction.

(6) The individual's preliminary income tax liability is the amount found by calculating the individual's income tax liability in accordance with section 23 of ITA 2007, ignoring Steps 6 and 7 of that calculation.

104. As I have mentioned above, these changes were made to reflect the introduction of ITA. ITA introduced a new step by step approach to the calculation of a person's income tax liability. That approach was set out in section 23. In the tax year 2007/08, section 23 ITA read as follows.

23. The calculation of income tax liability

To find the liability of a person ("the taxpayer") to income tax for a tax year, take the following steps.

Step 1
Identify the amounts of income on which the taxpayer is charged to income tax for the tax year.
The sum of those amounts is "total income".
Each of those amounts is a "component" of total income.

Step 2

Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24 to which the taxpayer is entitled for the tax year. See section 25 for further provision about the deduction of those reliefs.
The sum of the amounts of the components left after this step is "net income".

Step 3
Deduct from the amounts of the components left after Step 2 any allowances to which the taxpayer is entitled for the tax year under Chapter 2 of Part 3 of this Act or section 257 or 265 of ICTA (individuals: personal allowance and blind person's allowance).
See section 25 for further provision about the deduction of those allowances.

Step 4
Calculate tax at each applicable rate on the amounts of the components left after Step 3. See Chapter 2 of this Part for the rates at which income tax is charged and the income charged at particular rates.
If the taxpayer is a trustee, see also Chapters 3 to 6 and 10 of Part 9 (special rules about settlements and trustees) for further provision about the income charged at particular rates.

Step 5
Add together the amounts of tax calculated at Step 4.

Step 6
Deduct from the amount of tax calculated at Step 5 any tax reductions to which the taxpayer is entitled for the tax year under a provision listed in relation to the taxpayer in section 26.
See sections 27 to 29 for further provision about the deduction of those tax reductions.

Step 7
Add to the amount of tax left after Step 6 any amounts of tax for which the taxpayer is liable for the tax year under any provision listed in relation to the taxpayer in section 30.

The result is the taxpayer's liability to income tax for the tax year.

105. In summary, this calculation adds up income from various sources (Step 1), deducts reliefs which are taken into account in computing that income (Step 2) and any relevant allowances (Step 3). The applicable tax rates are then applied to the resulting income (Step 4). It is this income, "Step 3 income" that is referred to in the amended version of section 4 and section 6 TCGA that I have set out at [101] and [102] above.

106. At Step 6 of the calculation, the taxpayer is entitled to deduct "tax reductions" made under any provision listed in section 26 ITA. Section 539 ITTOIA is one of the provisions that are listed in section 26.

107. At least in the way that the legislation was worded, this marked a material change in the way in which CDR was given. Before these changes, for example, in the tax year 2006/07, CDR was expressed to be given as a deduction in calculating

total income. For the tax year 2007/08, CDR was given as a tax reduction after the calculation of income.

108. These changes are explained in the Annex 1 to the Explanatory Notes for ITA. "Change 3" in the Annex is as follows.

Change 3:

Tax calculation: relief for deficiencies: amendment to section 539 of ITTOIA: section 26 and Schedule 1 (section 539 of ITTOIA)

This change amends the way in which relief under section 539 of ITTOIA is given and introduces a formal claims requirement.

Section 539(1) of ITTOIA provides for relief for a deficiency to be given as a deduction from total income. But the mechanics of the relief as set out in section 539(3) to (5) show that it is intended to work as a computational adjustment to the amount of income tax payable. Accordingly, the relief is included with those that operate as tax reductions in section 26 of the Act, and section 539 of ITTOIA is itself amended to make the position clear.

Amended section 539 of ITTOIA adopts a step approach to the calculation of the reduction. Since the greatest reduction in tax is achieved by charging dividend income at the dividend ordinary rate instead of at the dividend upper rate (a reduction from 32.5% to 10%), Step 1 allocates the deficiency as far as possible to dividend income chargeable at the upper rate. On the same basis Step 2 deals with savings income charged at the higher rate (a reduction from 40% to 20%) and Step 3 with other income (a reduction from 40% to 22%). The treatment set out above does not apply to certain life annuity contracts made in the accounting period of an insurance company or friendly society beginning before 1 January 1992. In such a case the provisions of paragraph 109 of Schedule 2 to ITTOIA apply to treat the deficiency as an income deduction. That paragraph is itself consequentially amended by this Act to make the position clearer. The opportunity has also been taken to introduce a claims requirement in line with other insurance related reliefs (see Change 83). In practice, box 12.9 of the Self Assessment return does require a claim to relief. The introduction of a formal claims requirement regularises this practice and provides a straightforward way of resolving disputes.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

109. Although the changes made to section 539 ITTOIA did make a change to the law, it is clear from the supporting material that those responsible for the drafting of ITA took the view that those changes did not have any practical effect in terms of the amount of income tax payable by any person.

110. The changes made to section 4 and section 6 TCGA 1992 were made by paragraph 295 and paragraph 296 of Schedule 1 to ITA. This is the schedule of "minor and consequential amendments". The Explanatory Notes to ITA refer to the changes simply as follows:

> 3247. The amendments to references to "total income" operate by reference to "Step 3 income", defined by reference to section 23 of this Act, to reflect the standardised meaning of the phrase "total income". See the commentary on that section.

111. No specific reference is made to these provisions in the Annex of changes to the law. This may suggest that those responsible for the drafting took the view that these changes did not affect the interpretation of section 4 and section 6.

The parties' submissions

112. The parties agreed that the changes made to the legislation to give effect to the rewriting of the income tax legislation by ITA should not affect the interpretation of section 4 section 6 of the TCGA. This was subject to one point to which I shall refer below.

113. As a result, and subject to that point, in relation to the tax year 2007/08, the submissions made by the parties were substantially the same as those made in relation to the tax year 2006/07. On that basis, and for the reasons that I have given above, I would take the view that the amount of the deduction referred to in section 6(2)(a) can be an amount up to the amount of the deficiency, but that the reduction required by section 6(2) to Step 3 income of a person cannot reduce the Step 3 income to a negative figure.

114. I do, in passing, however note that section 6(2) in its amended form refers in its final words to the Step 3 income of a person being reduced by "the amount of the deficiency". This seems to make the amount argument even more difficult in relation to the tax year 2007/2008.

115. The caveat to that conclusion is that, in relation to the tax year 2007/08, HMRC raised one additional argument. This is the "gateway argument". HMRC says that it is relevant to the tax year 2007/08 and not to the tax year 2006/07 simply because in the tax year 2007/08, Mr Scott had material income which, in the absence of his claim to CDR, would have been taxable at the higher rate.

HMRC's arguments

116. On those facts, HMRC says that section 4(2) TCGA applies so that all of the gains of Mr Scott in the tax year 2007/08 are charged to tax at the higher rate. HMRC's arguments are as follows:

> (1) Mr Scott had income which was "chargeable" to tax at a higher rate. Although he did not pay tax at the higher rate because he was entitled to CDR, that income was chargeable at the higher rate and then reduced by a tax reduction.
>
> (2) This construction is consistent with the manner in which CDR is given. In section 539(5) (as it applied for the tax year 2007/08) the income tax liability

of an individual is calculated at Step 3 and Step 4. A tax reduction is then calculated at Step 6. In section 23 ITA a liability to income tax is calculated at Step 3 and charged at Step 4. Relief is then given by a tax reduction at Step 6 so tax is charged at the applicable rates at Step 4 before the reduction for CDR is given.

(3) This is consistent with the fact that CDR is a relief from extra liability. It can only apply if an individual is chargeable to income tax at higher rates.

(4) This argument is not dependent on any change of law taking place in the tax year 2007/08. The argument would have applied to the tax year 2006/07. However, in that year, Mr Scott benefitted from top-slicing relief under sections 535 to 537 ITTOIA.

Mr Scott's arguments

117. On behalf of Mr Scott, Mr Firth made the following submissions:

(1) There is no consistency in tax legislation concerning the use of the word "chargeable". It is necessary to look at the context and purpose of the particular provision to establish what is meant by "chargeable" in that context.

(2) In some contexts, "chargeable" refers to the tax that the person is actually required to pay, for example, a person's self-assessment is an assessment of "the amounts in which… the person making the return is chargeable to income tax and capital gains tax" (section 9(1)(a) TMA).

(3) The effect of the way in which CDR is given is that tax is only actually payable at the basic rate. This is acknowledged in the wording of section 539(1)(b) which states that an individual is entitled to a tax reduction in a year in which a deficiency arises if "the individual would (apart from this section) be liable to income tax at the higher rate".

(4) If HMRC are right, there was a radical and unintended change in the way in which CDR was given as a result of the changes made by ITA. Parliament clearly did not intend any such change.

(5) HMRC's interpretation produces an absurd result. A person with income £1 below the higher rate threshold (ignoring CDR) is entitled to relief from CGT. A person with £1 income above the higher rate threshold gets no relief at all.

(6) The interpretation is contrary to the purpose of the section. The purpose was to ensure that capital gains were taxed at the same effective rate that would apply if they were additional income. It is contrary to that purpose if a person with any amount of income in excess of the higher rate threshold is liable to capital gains tax at the higher rate even though, if they had received income instead of gains, the income would have been taxed at the basic rate.

(7) The consequential changes made to section 6(2) TCGA demonstrate that the intention of Parliament was for CDR to continue operating in the same way as it had done before.

Discussion

118. Section 4(2) TCGA provides that if income tax is "chargeable" at higher rates on the income of an individual in any year of assessment, all capital gains accruing in the year are to be taxed at the higher rate. HMRC's argument is that the exercise of determining whether income tax is "chargeable" at higher rates occurs before the application of CDR.

119. As a starting point, I agree with Mr Firth that the term "chargeable" is not applied consistently in the legislation. I therefore need to determine the meaning from the context in which it is used.

120. As with ITTOIA, ITA was enacted as part of the Tax Law Rewrite Project. As I mentioned at [73], the case law suggests that the correct approach in relation to these statutes is to treat them in the same way as other consolidating legislation (see the judgment of Sales J in *Eclipse Film Partners (No.35) LLP v. HMRC* [2013] UKUT (TCC) 639 at paragraph 97 and the decision of the Upper Tribunal (Judge Herrington and Judge Scott) in *Scambler v. HMRC* [2017] UKUT 0001 (TCC) at [47]) So they should be interpreted without any need for reference back to earlier statutes unless the relevant provision is found to be ambiguous or there is a real and substantial difficulty in interpreting the legislation using the normal canons of construction.

121. At first sight, section 23 ITA seems to support HMRC's argument. Amounts of income are determined, after giving effect to reliefs and allowances, at the end of Step 3 in the calculation. Tax is then calculated in Step 4 by applying the applicable rates to those amounts of income. It is not until Step 6 in the calculation set out in section 23 that the tax reduction for CDR is applied, that is after income has been determined (at Step 3) and tax has been calculated (at Step 4). This method of calculation is consistent with the manner in which CDR is given under section 539 ITTOIA after giving effect to the changes made by ITA.

122. If, however, the reference to income tax being "chargeable" in section 4(2) TCGA is read as a reference to the process by which tax is calculated at Step 4 on the amounts of income determined at Step 3 of the calculation in section 23 ITA, some difficulties arise.

123. First, as Mr Firth points out, CDR is a relief from tax at higher rates. It cannot apply unless the taxpayer is otherwise liable to income tax at higher rates (see section 539(1)(b) ITTOIA, in the form that applied in the tax year 2006/07). So a person who claims CDR must have income which, but for CDR, would be taxed at higher rates. If the argument is that the reference to income tax being chargeable in section 4(2) is a reference to the calculation of tax at Step 4 in section 23, it is difficult to envisage any cases in which a person who has claimed CDR could fall within section 4(3) TCGA because that person would by definition have income which is "chargeable" to income

tax at higher rates before the application of CDR. Section 6(2)(a) would be largely redundant.

124. Mr Pritchard says this is not the case. Section 6(2)(a) could apply in a case where an individual has claimed top-slicing relief under sections 535 to 537 ITTOIA. Top-slicing relief applies to "annualize" gains arising on insurance policies for the purpose of calculating applicable rates of tax. It is given at Step 6 of the calculation in section 23 ITA. Where top-slicing relief is given, two adjustments are made for the purposes of calculating rates of CGT under section 4 TCGA by section 6(3): first, only the annualized gain is taken into account in determining income in section 4(4) TCGA (section 6(3)(a) TCGA); second, a person is not treated as having paid income tax at higher rates for the purpose of section 4(2) and section 4(3) TCGA where the calculation for top-slicing relief has not involved higher rates of tax (section 6(3)(b) TCGA). So, in a case where top-slicing relief was claimed, a person could have income that was "chargeable" at higher rates (under the Step 4 process) – so that the condition in section 539(1)(b) ITTOIA would be met and CDR could be claimed – but section 4(2) might not apply if - as a result of the application of section 6(3)(b) TCGA – the top-slicing calculation did not involve the application of higher rates. Furthermore, the presence of section 6(3)(b) shows that the legislation does seek to address the potential effect of the application of the step by step calculation process in section 23 ITA.

125. Mr Firth says that it cannot be the case that section 6(2)(a) TCGA was only intended to apply in such limited circumstances. Top-slicing relief is only likely to apply in relation to a different insurance policy from that on which CDR is claimed. This is because CDR only arises on the termination of a policy. The only case in which a chargeable event (to which top-slicing could apply) and a termination could possibly arise in the same year for the same policy would be if there was an earlier partial surrender of the policy. But partial surrenders are not chargeable events if they arise in the final year (section 509(5) ITTOIA). So there is no link between whether a person has CDR and top-slicing relief in the same year and it is difficult to see why the availability of reduction in CGT rates as a result of CDR should depend upon the availability of top-slicing relief. I tend to agree with Mr Firth on this point.

126. Second, if HMRC are correct, the term "Step 3 income" is not consistently applied throughout section 4. As a result of the amendments made by ITA, section 4(4) TCGA contains a reference to "Step 3 income" instead of the previous reference to "total income". No change is made to section 4(2) which continues to refer to "any part of the income of an individual". If the reference to income tax being "chargeable" in section 4(2) is a reference to the calculation of tax at Step 4 in section 23 on the amounts on income determined at Step 3, one might have expected a corresponding change to be made to section 4(2) to include a reference to "Step 3 income".

127. Finally, Mr Pritchard says that this was the effect of the legislation before the changes made by ITA. The only reason that the gateway argument did not apply to Mr Scott in the 2006/07 tax year is that in that year he had no income that was otherwise subject to tax at higher rates because of the application of top slicing relief

under sections 535 to 537 ITTOIA. As a result, section 6(3)(b) applied to treat Mr Scott as having no income that was chargeable at the higher rates.

128. I disagree. In my view, the gateway argument was not available to HMRC in relation to the tax year 2006/07. As I have described above, in the tax year 2006/07, the relevant legislation (section 539 ITTOIA) expressed CDR to be given as an adjustment to total income for the purpose of calculating liability to income tax at higher rates. Total income is determined before tax is charged. So the effect of that wording when it was translated into the legislation which determined the rates of CGT (sections 4 and 6 TCGA) was clear. In particular, in section 4(2) TCGA, the reference to income tax being chargeable on any part of an individual's income must be a reference to income as determined after giving effect to CDR. At no point was that income "chargeable" to income tax at a higher rate as required by section 4(2). It is only in this way that full effect was given to section 4(3), section 4(4) and section 6(2) in a case where CDR is claimed (in the manner that I have described in relation to the tax year 2006/07).

129. It follows that, if HMRC is correct that the gateway argument applies in relation to the tax year 2007/08, the introduction of ITA potentially made a material change in the law governing the rates of CGT in cases where CDR was claimed.

130. Mr Firth says that there is no evidence that there was any intention on the part of the Parliament to change the law in this respect. He points to the final words of the relevant section in Annex 1 to the Explanatory Notes which refer to the changes in the manner in which CDR was given (to which I refer at [108] above) and in particular to the statement that "this change has no implications for the amount of tax due, who pays it or when". That statement would, of course, appear to be directed at the income tax consequences of the change in the method of calculation of CDR rather than the CGT implications. However, Mr Firth also notes that the changes made to section 4 and section 6 TCGA were regarded as consequential amendments having no material effect.

131. As I have mentioned at [120] above, I should resort to the legislative history of ITA only if the revised legislation is ambiguous or if there is real difficulty in interpreting the legislation using the normal canons of construction. For the reasons that I have given above, in my view, there is sufficient difficulty in interpreting section 4 TCGA to justify referring to the previous legislation. When I do so, to my mind, the changes made to section 4 TCGA by ITA are clearly designed to preserve the manner in which rates of CGT were determined notwithstanding the changes to the way in which CDR was given for income tax purposes. So, in my view, there was no material change in the way in which rates of CGT were calculated as between the tax years 2006/07 and 2007/08. And the question as to whether income tax is chargeable at higher rates in section 4(2) in the tax year 2007/08 must be determined by reference to the rates effectively charged after giving effect to CDR.

132. In my view, the structure of the legislation in the tax year 2007/08 supports this view.

(1) First, as I have mentioned above, no change was made to the wording of section 4(2) itself. Despite several references to "Step 3 income" being introduced into section 4 TCGA by ITA, no such reference was introduced in sub-section (2). To my mind, "income" in section 4(2) must therefore potentially bear a different meaning to "Step 3 income". And the reference to income tax being "chargeable" must extend to circumstances other than the calculation of tax at Step 4 of the calculation in section 23 ITA.

(2) Second, section 6(2) TCGA is amended by ITA to reduce Step 3 income for the purposes of section 4(4) by "the amount of the deficiency" rather than the amount of the deduction made by section 539 ITTOIA. This is necessary because, following the introduction of ITA, CDR is being given as a tax reduction at Step 6 of the calculation in section 23 ITA rather than as an adjustment to an amount of income. However, the determination of the rates of CGT in section 4 is made by reference to amounts of income not amounts of tax. The adjustment made by section 6(2) is intended to ensure that the determination of the rates of CGT is made by reference to the amount of income that is relieved from higher rate tax by virtue of CDR (as it was before the changes made by ITA) rather than the tax reduction specified in the new calculation in section 23 ITA.

133. Furthermore, I agree with Mr Firth that it seems improbable that Parliament can have intended to make a material change to the legislation governing the rates of CGT through the minor and consequential amendments made in the Schedule to ITA. The legislative history and the manner in which the changes were made, in my view, support the conclusion that I have reached.

134. For these reasons, I have rejected the gateway argument.

Conclusions

135. As I have mentioned above, the parties agreed that, in all other respects, the interpretation of section 4 and section 6 TCGA in the tax year 2007/08 should be the same as that in the tax year 2006/07, notwithstanding the changes made to the legislation by ITA.

136. On that basis, and for similar reasons, I take the view that the amount of the deduction referred to in section 6(2)(a) can be an amount up to the full amount of the deficiency, but that the reduction required by section 6(2) to the Step 3 income of a person cannot reduce the Step 3 income to a negative figure (for the purposes of computing the unused part of an individual's basic rate band in section 4(4) TCGA).

THE PROCEDURAL ISSUE

137. The second issue before the Tribunal is whether or not the HMRC is entitled to enquire into its own calculation of a tax liability. This is referred to by the parties as the "procedural issue".

Facts

138. The relevant facts surrounding the submission of Mr Scott's returns for the tax year 2006/07 and the tax year 2007/08 are set out in the statement of agreed facts in Appendix 1.

Evidence

139. As I mentioned at [8], Mrs Maureen Crewe and Mr Keith Graham, both officers of HMRC, gave evidence to the Tribunal.

140. Mrs Crewe's evidence concerned the manner in which the self-assessment system operates in practice. I did not gain much of relevance to the questions before the Tribunal from her evidence. Much of her evidence set out HMRC's interpretation of the relevant statutory provisions. Those are matters of law for the Tribunal to decide.

141. Mr Graham is responsible for technical specifications for the on-line tax calculator that is used on the HMRC website. The bulk of Mr Graham's evidence related to the design of the tax calculator on HMRC's website and the provision of technical data to third party software developers who develop commercially available software to assist taxpayers with the submission of on-line returns.

142. I took the following facts from Mr Graham's evidence.

143. The technical specifications are used by HMRC software developers to develop the online filing system, by third party software providers that develop commercially available software that interfaces with HMRC's systems to allow for on-line filing of tax returns and by the HMRC software developers that design software for the storage of returns.

144. The on-line calculator is tested against a vast array of fact patterns but it would not be possible to test the calculator against all potential fact patterns. It is not infallible. This is acknowledged on HMRC's website. Some of the potential errors that might be thrown up by the tax calculator are known. These known problems are dealt with in one of two ways: the first category are known as "specials", these are situations in which a "work-around" can be used to enter the figures in a particular way using the software in order to produce the correct result; the second category are known as "exceptions", these are cases where it is known that the software will not produce the correct result, but there is no known work-around using the software. In these cases, the taxpayer has to file a paper return.

145. The number of specials and exceptions in each tax year varies depending upon the number of changes that have been made to the tax legislation. For example: in the tax year 2006/07, there were 15 specials and 8 exceptions; in the tax year 2007/08, there were 71 specials and 39 exceptions.

146. In November 2007, a tax agent informed HMRC of a potential problem with the calculation of CGT in cases where CDR was claimed. Mr Graham says that it was too late to amend the tax calculator for the tax year 2007/08 at that stage.

147. In the 2007/08 tax year, only 13 cases involving the interaction of the rules governing CDR and CGT rates were identified in which the tax calculator produced what HMRC believed to be an incorrect result. Mr Scott's case was one of those cases. The total tax at stake in the other 12 cases was £23,000. In Mr Scott's case it was £3.1 million.

The Tribunal's jurisdiction

148. As a preliminary point in relation to the procedural issue, HMRC questioned the jurisdiction of the Tribunal to determine the issue. I will address this point before turning to the procedural issue itself.

The law

149. I was referred to the following provisions in TMA.

> 48. **Application to appeals and other proceedings**
>
> (1) In the following provisions of this Part of this Act, unless the context otherwise requires -
>
> (a) "appeal" means any appeal under the Taxes Acts;
>
> …..
>
> 49G. **Notifying appeal to tribunal after review concluded**
>
> (1) This section applies if -
>
> (a) HMRC have given notice of the conclusions of a review in accordance with section 49E, or
>
> (b) the period specified in section 49E(6) has ended and HMRC have not given notice of the conclusions of the review.
>
> (2) The appellant may notify the appeal to the tribunal within the post-review period.
>
> (3) If the post-review period has ended, the appellant may notify the appeal to the tribunal only if the tribunal gives permission.
>
> (4) If the appellant notifies the appeal to the tribunal, the tribunal is to determine the matter in question.
>
> (5) In this section "post-review period" means –

(a) in a case falling within subsection (1)(a), the period of 30 days beginning with the date of the document in which HMRC give notice of the conclusions of the review in accordance with section 49E(6), or

(b) in a case falling within subsection (1)(b), the period that -

(i) begins with the day following the last day of the period specified in section 49E(6), and

(ii) ends 30 days after the date of the document in which HMRC give notice of the conclusions of the review in accordance with section 49E(9).

49H. **Notifying appeal to tribunal after review offered but not accepted**

(1) This section applies if -

(a) HMRC have offered to review the matter in question (see section 49C), and

(b) the appellant has not accepted the offer.

(2) The appellant may notify the appeal to the tribunal within the acceptance period.

(3) But if the acceptance period has ended, the appellant may notify the appeal to the tribunal only if the tribunal gives permission.

(4) If the appellant notifies the appeal to the tribunal, the tribunal is to determine the matter in question.

(5) In this section "acceptance period" has the same meaning as in section 49C.

50. **Procedure**

(6) If, on an appeal notified to the tribunal, the tribunal decides –

(a) that the appellant is overcharged by a self-assessment;

(b) that any amounts contained in a partnership statement are excessive; or

(c) that the appellant is overcharged by an assessment other than a self-assessment,

the assessment or amounts shall be reduced accordingly, but otherwise the assessment or statement shall stand good.

(7) If, on an appeal notified to the tribunal, the tribunal decides –

(a) that the appellant is undercharged to tax by a self-assessment;

(b) that any amounts contained in a partnership statement are insufficient; or

(c) that the appellant is undercharged by an assessment other than a self-assessment,

the assessment or amounts shall be increased accordingly.

HMRC's submissions

150. Mr Pritchard for HMRC says that this ground of appeal is in reality a public law issue that has been dressed-up as a substantive issue. The correct means of challenge to the assessment on these grounds is by judicial review.

151. He submits that the Tribunal does not have jurisdiction in respect of this issue. He says that the Tribunal is a creature of statute: it can only decide matters prescribed by statute to fall within its jurisdiction. In direct tax matters, the jurisdiction of the Tribunal is determined by section 50(6) and (7) TMA. The Tribunal can only decide if the Appellant has been overcharged or undercharged as a result of an assessment. He cites the decision of the First-tier Tribunal (Judge Berner and Mrs Amanda Darley) in *Rotberg v HMRC* [2014] UKFTT 657 (TC) at [116] in support of this submission and says that, as a result, the jurisdiction of the Tribunal is limited in direct tax cases to determining whether or not the correct amount of tax has been charged under the law.

Mr Scott's submissions

152. For Mr Scott, Mr Firth says this is a question of deciding the meaning of the reference to "enquire" in section 9A TMA. That is a matter of the interpretation of the tax legislation. Such matters are within the jurisdiction of the Tribunal. The source of the Tribunal's jurisdiction is section 49G(4) or section 49H(4) each of which requires the Tribunal to "determine the matter in question".

153. The question is simply whether HMRC had power to raise this assessment. That is a matter within the tax legislation. There are many examples of matters which do not directly relate to the calculation of the tax charge which fall within the jurisdiction of the Tribunal. For example, the Tribunal can and often does determine whether the conditions for the issue of a discovery assessment under section 29 TMA are met.

154. The decision in *Rotberg* is not relevant. It related to a claim that a tax charge which would otherwise have arisen under the law should not be imposed on the taxpayer because a representation made by HMRC had given rise to a legitimate expectation. It was clear that such matters could only be determined by judicial review.

Discussion

155. I was not referred by the parties to any of the case law on the limits of the jurisdiction of the Tribunal other than the decision of the FTT in *Rotberg*. It was accepted by the parties that, as the Tribunal is a creature of statute (section 3 TCEA

2007), it can only decide matters prescribed by statute. The Tribunal does not have general or inherent powers to supervise the conduct of HMRC or any other public body by way of judicial review.

156. It follows that any question regarding the scope of the Tribunal's jurisdiction to hear any particular matter is a question of construction of the statute which gives rights of appeal to the Tribunal or defines the powers of the Tribunal in the particular case in question. But it does not follow that the Tribunal can never consider public law matters. It can and must do so if it is necessary in relation to matters that fall within its jurisdiction as prescribed by statute. (There is authority for this proposition in some of the cases referred to in *Rotberg*, see for example *HMRC v Noor* [2013] UKUT 71 (TCC) at [31] and [56], *Oxfam v HMRC* [2009] EWHC 3078 (Ch) at [68].)

157. In the present case, the rights of the taxpayer to appeal to the Tribunal against a closure notice are set out in section 31(1)(b) TMA. On an appeal, the Tribunal is "to determine the matter in question" (see section 49G(4) or section 49H(4) TMA and similar wording, to which I was not referred, in section 49D(3) TMA). If we stop at that point, the jurisdiction of the Tribunal would appear to be very broad and would seem to be capable of encompassing both whether the amendments required by the closure notice result in the correct amount of tax being charged and whether those amendments can be made at all. However, as was discussed in *Rotberg*, the jurisdiction of the Tribunal is constrained by the remedies which it is able to give and the circumstances in which it is able to give them. These are set out in section 50(6) and (7). For present purposes, the important provision is section 50(6), which permits the Tribunal to reduce an assessment if the taxpayer has been "overcharged" by the assessment.

158. At [109] to [117] of its decision in *Rotberg*, the FTT discussed the scope of section 50(6). It said this:

> "109 What we can derive from *Oxfam* and *Noor* is that, once it is accepted (as it was in both cases) that the First-tier Tribunal has no general supervisory jurisdiction, the question of jurisdiction is not one of principle but one of statutory construction. In the case of s 50(6) the answer to that question turns on the meaning to be ascribed to "the appellant is overcharged" in s 50(6)(a) and (c).
>
> 110 Miss McCarthy submitted that "overcharged" should be construed as synonymous with "excessive", arguing that "excessive" had a broader meaning than simply whether the tax charge had been calculated correctly. By the same token she submitted that the question whether a taxpayer has been "overcharged" by an amendment or assessment looks to the determination of the tax lawfully due, and that whether or not such a determination is lawful (in other words, in accordance with the law) is capable of encompassing public law arguments."

After dismissing in [111] the relevance of certain FTT decisions on non-fixed penalties, the FTT continued:

> "112 Nor do we consider that "overcharged" can be construed so as to focus, not on the charge itself, but on the determination of the tax lawfully due. In our view, s 50(6)

is confined to the lawfulness of the charge under the legislation, and not to its determination. For that reason, we do not consider that reliance can be placed on cases in the Asylum and Immigration Tribunal, such as *AA and Others (Highly skilled migrants: legitimate expectation) Pakistan* [2008] UKAIT 0003 , in which public law arguments, including legitimate expectation, were held to be within the tribunal's jurisdiction under a statutory ground of appeal under s 84(1)(e) of the Nationality, Immigration and Asylum Act 2002 that applied if "the decision is otherwise not in accordance with the law". The jurisdiction in those cases is in relation to the decision, and as such the tribunal is able to consider whether the Secretary of State had failed to act in accordance with established principles of administrative or common law; in s 50(6) TMA it is confined to the question whether the appellant is overcharged. Our view on the impact of the immigration cases corresponds to that taken by the Upper Tribunal in *Noor* (at [86]) in relation to *Nipa Begum v Tower Hamlet London BC* [2000] 1 WLR 306 , a case on the particular right of appeal under s 204 of the Housing Act 1996 .

113 Of more relevance to a case in the direct tax field, however, is that of *Aspin v Estill* [1987] STC 723 . In that case the taxpayer, Mr Aspin, a British subject, had worked in the United States for 20 years before returning to the UK in 1978. He was entitled to a US pension. Mr Aspin's evidence was that on arriving in the UK in January 1978 he had asked a member of a tax office whether his US pension was subject to UK tax, and he had been informed that it was not. Relying on that statement he purchased property in the UK and, in due course, before discovering that the Revenue's position was different, he lost his right to return to the US on his visa. On appeal against assessments to the general commissioners, it was held that the income from the US pension was taxable under Case V of Schedule D, the general commissioners taking the view that the matter of what Mr Aspin had been told was not relevant to the issue before them.

114 That position was endorsed both in the High Court and in the Court of Appeal. There the principal judgment was given by Sir John Donaldson MR, with whom Mustill LJ and Nicholls LJ agreed. It was held that if Mr Aspin had a remedy it could only lie in judicial review, which could be considered only by the High Court. In expressing his agreement with this conclusion, Nicholls LJ said (at p 727c):

> "The taxpayer is saying that an assessment ought not to have been made. But in saying that, he is not, under this head of complaint, saying that in this case there do not exist in relation to him all the facts which are prescribed by the legislation as facts which give rise to a liability to tax. What he is saying is that, because of some further facts, it would be oppressive to enforce that liability. In my view that is a matter in respect of which, if the facts are as alleged by the taxpayer, the remedy provided is by way of judicial review."

115 The circumstances of Mr Aspin are analogous to those of Mrs Rotberg in this case. In both cases there is no question as to the proper application of the tax provisions themselves. In both some measure of assurance was sought and obtained from HMRC, in Mr Aspin's case by the taxpayer himself, and for Mrs Rotberg by her accountant, in advance of the relevant taxable event. In both cases the submission is that the taxpayer has both done something to their detriment, and lost the opportunity to rectify matters.

116 *Aspin* is therefore, in our view, authority that the jurisdiction of the First-tier Tribunal in direct tax cases of this nature is limited to considering the application of the

> tax provisions themselves. On that basis, s 50(6) falls to be construed so as to refer only to the case where the charge to tax made on the assessment or amendment exceeds that which the tax legislation provides. There is thus no jurisdiction for the tribunal to apply the public law principle of legitimate expectation, even in a case where a relevant degree of assurance is provided before the event, and the taxpayer has done something to his detriment in reliance on that assurance. On this reading of s 50(6), therefore, a challenge can only arise in respect of the enforcement of the liability. That, according to Aspin, is something that can only be achieved on judicial review.
>
> 117 We conclude therefore, on this construction of s 50(6) , that we have no jurisdiction to consider Mrs Rotberg's arguments on legitimate expectation. We should add that, even if a wider reading of s 50(6) had been possible, it would not in our judgment have been of sufficient breadth to cover this particular case. In considering the question of jurisdiction, it is relevant in our view to have regard, as the Upper Tribunal did in Noor , to the remedy that would be required to give effect to the taxpayer's legitimate expectation. The starting point in that analysis must be the nature of the expectation that has arisen. In this case it was not simply that the gains on the share disposals would be free of tax; it was that there would be no gain on the share disposals because of the operation of a deferral relief under which there is deemed to be an adjustment in the acquisition cost of the replacement shares."

159. It is important to set these comments in the context of the facts of the case. In that case, Mrs Rotberg was seeking to argue that the various assessments that were made on her should be reduced to nil under section 50(6) on the grounds that certain representations made by HMRC gave rise to a legitimate expectation on the part of Mrs Rotberg that no tax would be payable on the disposals. It is therefore typical of the type of case where the court or tribunal is being asked to refrain from imposing a liability or to relax a restriction on a relief imposed by the law on the basis of a public law argument, for example, that the action of HMRC is such that the taxpayer has a legitimate expectation that the liability will not be imposed or that relief will be allowed. Unless there is specific statutory authority, these cases are not within the jurisdiction of the Tribunal. They can only be the subject of judicial review. There are several examples of this type of case in the authorities (see for example, *Noor* and *Aspin v Estill*, which was referred to in the extract from the FTT decision in *Rotberg* to which I have referred).

160. The argument raised by Mr Scott in this case somewhat different. In summary, he says that the amendments made to his returns by the closure notices are invalid because the closure notices can only make amendments based on the results of an enquiry under section 9A and HMRC had no power to make an enquiry of this nature under section 9A.

161. I accept Mr Pritchard's arguments that some aspects of this ground of appeal are dangerously close to a pure public law argument of the kind that has already been rejected by the High Court. However, in the manner in which it is put, Mr Scott is, in essence, arguing that a condition to the issue of a closure notice in this form has not been met and that condition (whether there has been an enquiry under section 9A) is one prescribed by the statute. It seems to me that those are matters that can be

properly raised as a challenge to an assessment made pursuant to a closure notice within the terms of section 49D(3), section 49G(4) or section 49H(4).

162. The question is whether there is anything in section 50(6) that should constrain the Tribunal from determining that issue. In my view, there is not.

163. The first consideration is whether Mr Scott could be said to "overcharged" by the assessment if his appeal is successful on this ground. In my view, he would be "overcharged" if an assessment was made and one of the conditions specified by the legislation for the making of that assessment was not met. The process of amending a return through the issue of closure notices is an integral part of the process of assessing and charging tax under the legislation. In that context, a taxpayer is just as much "overcharged" if an assessment is made on the taxpayer when it should not have been because a condition contained in the legislation for making the assessment has not been met as he or she would be if the tax charge contained in the assessment is not computed in accordance with the tax legislation.

164. In this respect, I acknowledge the comments in the decision of the FTT in *Rotberg* to the effect that "overcharged" had to be construed as focussing on the charge to tax itself rather than the on manner in which it had been determined (in particular, at [112]). Given their context, I read the references to the lawfulness of the determination of the charge as being a reference to whether the charge could be subject to challenge as a public law matter outside the purview of the tax legislation. If the FTT's view was that section 50(6) limits the Tribunal's jurisdiction to matters relevant to the calculation of the amount of the tax charge and excludes consideration of whether the assessment was validly made by reference to conditions in the tax legislation, then I disagree. But I do not believe that that was the case. For example, the FTT refers to the jurisdiction of the Tribunal extending to "considering the application of the tax provisions themselves" (at [115] and [116]).

165. The second potential constraint is whether the remedy available to the Tribunal (reducing the assessment) is an appropriate remedy given the nature of the claim (see *Rotberg* [117]). In this case, none of the concerns raised in *Rotberg* arise. The reduction of the assessments would be an appropriate remedy.

Conclusion

166. I conclude, therefore, that the Tribunal does have jurisdiction to hear the procedural issue.

The procedural issue

167. I shall then move on to consider the procedural issue itself.

The law

168. I was referred to section 9A and section 28A TMA. They are set out below, so far as relevant, in the form that applied in the tax year 2014/15; the year in which the closure notices were issued.

9A. **Notice of enquiry**

(1) An officer of the Board may enquire into a return under section 8 or 8A of this Act if he gives notice of his intention to do so ("notice of enquiry") –

(a) to the person whose return it is ("the taxpayer"),

(b) within the time allowed.

(2) The time allowed is -

(a) if the return was delivered on or before the filing date, up to the end of the period of twelve months after the day on which the return was delivered;

(b) if the return was delivered after the filing date, up to and including the quarter day next following the first anniversary of the day on which the return was delivered;

(c) if the return is amended under section 9ZA of this Act, up to and including the quarter day next following the first anniversary of the day on which the amendment was made.

For this purpose the quarter days are 31st January, 30th April, 31st July and 31st October.

(3) A return which has been the subject of one notice of enquiry may not be the subject of another, except one given in consequence of an amendment (or another amendment) of the return under section 9ZA of this Act.

(4) An enquiry extends to -

(a) anything contained in the return, or required to be contained in the return, including any claim or election included in the return,

(b) consideration of whether to give the taxpayer a transfer pricing notice under section 168(1) of TIOPA 2010 (provision not at arm's length: medium-sized enterprise),

(c) consideration of whether to give the taxpayer a notice under section 81(2) of TIOPA 2010 (notice to counteract scheme or arrangement designed to increase double taxation relief),

but this is subject to the following limitation.

…

28A. **Completion of enquiry into personal or trustee return**

(1) An enquiry under section 9A(1) of this Act is completed when an officer of the Board by notice (a "closure notice") informs the taxpayer that he has completed his enquiries and states his conclusions.

In this section "the taxpayer" means the person to whom notice of enquiry was given.

(2) A closure notice must either -

(a) state that in the officer's opinion no amendment of the return is required, or

(b) make the amendments of the return required to give effect to his conclusions.

(3) A closure notice takes effect when it is issued.

(4) The taxpayer may apply to the tribunal for a direction requiring an officer of the Board to issue a closure notice within a specified period.

….

Mr Scott's arguments

169. Mr Firth referred to the system of assessment before the introduction of self-assessment in in 1997. Under that system, HMRC raised assessments based on information provided by the taxpayer. There was no system of enquiry into assessments. If it wanted to correct an assessment, HMRC had to raise a further assessment, but HMRC could not raise a further assessment if the point that it later disputed was one which was fundamental to the original assessment.

170. When self-assessment was introduced, HMRC was granted powers to enquire into assessments produced by taxpayers. But, Mr Firth argued, there was no intention to reverse the position that HMRC could not change its mind about something that it had already decided. It was not intended as a process under which HMRC could reverse its own errors.

171. In support of this submission, Mr Firth made the following points:

(1) The natural meaning of "enquire" in section 9A is to scrutinize something with a view to finding out more about it. The word "enquire" cannot sensibly be applied to a process in which HMRC looks into a calculation that it produced itself.

(2) If HMRC wants to correct an error that it has made itself, it should use a discovery assessment. The discovery assessment provisions in section 29 TMA include appropriate safeguards to protect taxpayers.

(3) The provisions governing HMRC determinations (in section 28C TMA) demonstrate that the legislation does not contemplate that HMRC can enquire

into its own actions. There is no provision for HMRC to enquire into a determination. That is because a determination is something that HMRC has done.

(4) Furthermore, Parliament cannot have intended that a taxpayer who submits a return in respect of which HMRC calculate the tax to be in a worse position – in terms of being exposed to the risk of an enquiry - than a taxpayer who submits no tax return and is subject to a determination.

(5) If HMRC is able to enquire into things that it has done, it would leave taxpayers with no protection from the consequences of HMRC's own errors. As Mr Scott's own case demonstrated, a taxpayer was unlikely to be able to bring judicial review proceedings in such cases. This was because it was unlikely that HMRC would be regarded as having made a representation sufficient to form a legitimate expectation on the part of the taxpayer.

HMRC's arguments

172. Mr Pritchard rejected the argument that there should be any such limitation on HMRC's powers to enquire into a return under section 9A TMA. He says that the wording of section 9A(4) is deliberately broad. HMRC can enquire into "anything contained in the return". There is no limitation on the matters contained in the return into which HMRC can enquire.

173. He made the following points in response to Mr Firth's submissions.

(1) The introduction of the self-assessment regime was an entirely new regime with its own procedures and rules. Any reference to the regime that was in place before the introduction of self-assessment is irrelevant.
The return was made by Mr Scott. It was his return and he remained responsible for it.

(2) As practical matter, if Mr Scott was right and HMRC was to be held to any view that it expressed at some point in the course of an enquiry, the enquiry system would become unworkable. If correct, Mr Scott's argument would prevent any part of the tax calculation from being subject to an enquiry if the calculation had been made in accordance with HMRC's software. This cannot have been Parliament's intention. It is an important part of the enquiry process that HMRC (and the taxpayer) can raise any issue whilst the enquiry remains open.

(3) It is not true that there are no safeguards for the taxpayer in the enquiry process. There are time limits for opening an enquiry. The taxpayer has rights to appeal to the Tribunal if he or she is dissatisfied with the outcome. In cases where taxpayer has relied on a representation, the taxpayer may be able to bring judicial review proceedings.

(4) The reference to HMRC determinations does not assist Mr Scott. HMRC makes a determination when it has not received a return. It is a best estimate of the tax due and so there can be no enquiry into it.

174. Mr Pritchard also referred to some of the comments made by Judge Nowlan in granting permission for Mr Scott to add this additional ground of appeal (*Scott v. HMRC* [2016] UKFTT 171 at [18]). Those observations were as follows :

"[18] The reasons why I consider that, had the test been one of the balance of probability, the Respondents would have prevailed, are as follows:

- The Appellant has to place too much reliance on the meaning of the word "enquire" and I would have rejected the proposition that the notion of the enquiry was confined to considering facts and legal interpretations advanced by the taxpayer.
- Even if, when considering the interpretation of section 9A (4)(a) the opening word "enquiry" has the meaning contended for by the Appellant, it is still difficult to dispute that an enquiry has certainly been opened, and when the relevant paragraph clearly indicates what can be dealt with in the enquiry it seems odd to find other restrictions buried in the claimed meaning of the word "enquiry".
- There appears to be some consistency in considering the point at which Parliament intends the taxpayer to be able to rely on "finality". In Olin it seems clear that if there had been discussions between HM Revenue and the taxpayer in which the Inspector had initially indicated that he expected to be able to allow the offset of the losses against the profits of the only continuing trade, but before making the assessment on that basis the Inspector suddenly realised that his approach had been wrong, I do not consider that the Inspector would have been precluded from denying the offset of the losses and making an assessment accordingly. Similarly in the present day case where HMRC make an assessment on a taxpayer who has not filed a return, it seems obvious that even if for some period HMRC suggests that it will adopt one approach but then changes that approach before making the assessment, there can be no objection to that change of approach, even though it will inherently not involve, and cannot involve, opening an enquiry. Consistently, therefore, in the present situation if HMRC had not changed their basis of calculation and the enquiry had been closed on the basis that the assessment would be left with the rate of tax being 20%, then the ability to make a later change to that, and a further assessment, would all revolve around the discovery provisions and the feature of the original assessment having been based on a full provision of the facts and the "then prevailing application of the law". But if the change, on the part of HMRC, occurs during the period when the enquiry is still open, it seems to me that the better view is that HMRC can change their initial stance, and effectively reverse the initial basis of calculation in the open return."

Discussion

175. The detail of the facts surrounding the submission of Mr Scott's returns for the years in question is set out in the statement of agreed facts in Appendix 1. In summary, on both occasions, the return included a calculation of tax due which was produced using third party software which had been created using HMRC's specifications and algorithms. In both cases, those calculations gave effect to CDR by extending the basic rate band and showed tax payable on capital gains at the rate of 20%.

176. Mr Firth says that HMRC cannot "enquire" into these calculations under section 9A TMA because these calculations were "done" by HMRC. I disagree.

177. The wording of section 9A(4)(a) is clear. HMRC is entitled to enquire into "anything contained in the return". That wording is broad and would naturally extend to the calculation of tax payable that is contained in the return. I can see no justification for limiting HMRC's enquiry to facts and information provided by the taxpayer in the manner suggested by Mr Firth.

178. Mr Firth refers to the legislation that preceded the introduction of the self-assessment regime in 1997. The self-assessment regime was an entirely new regime. There is no reason to infuse that regime with concepts borrowed from prior legislation.

179. I agree with Mr Pritchard that to impose constraints on the enquiry process of this nature would undermine that process. The process needs to be an iterative one. I cannot deduce from the words of the legislation any intention on the part of Parliament to limit the enquiry process in a manner that prevents HMRC from correcting its own errors whilst the enquiry remains open.

180. I also accept Mr Pritchard's points that to impose any such limit would severely restrict HMRC's ability to assist taxpayers in completing their returns. The natural reaction of HMRC to a decision that, in essence, it could not enquire further into any aspects of the return derived from information provided by HMRC itself would be for HMRC to be much more guarded about the assistance that it provides. That could only be to the detriment of the majority of taxpayers who cannot afford to instruct professional advisers to complete their returns.

181. Mr Firth says that the effect of a broader interpretation of the word "enquire" is that the taxpayer is deprived of essential safeguards. Once again, I disagree. There are appropriate safeguards in the legislation. There are time limits on opening an enquiry (in section 9A(2) TMA) and provisions under which the taxpayer can request the Tribunal to bring an enquiry process to an end (section 28A(4) TMA). Following the completion of an enquiry, the taxpayer has the right to appeal to this Tribunal and in appropriate circumstances the taxpayer may be able to bring judicial review proceedings in respect of actions taken by HMRC.

182. Finally Mr Firth refers to the process for the issue of determinations under section 28C TMA. He says that there is no provision for the opening of an enquiry in

relation to a determination. That is clearly correct. He says that this is because a determination is something "done" by HMRC and so it would not make sense to include a provision under which HMRC enquires into something that it has done.

183. I do not draw the same conclusions from the omission of an enquiry process in relation to the issue of a determination. As Mr Pritchard points out, a determination is issued when no self-assessment has been made. There is nothing to enquire into. It is a separate process. I do not need to decide this point, but, if HMRC made an error in a determination, my inclination is that it would be able to issue a further determination in order to correct that error. In that respect, I agree with the observations of Judge Nowlan to which I refer at [174] above.

184. Even if I had been inclined to accept that a limitation of the nature of that proposed by Mr Firth should be read into the wording of section 9A(4), I would have found it difficult to extend that limitation to the facts of this case. All that HMRC has "done" in relation to the relevant returns in this case is supply technical specifications to the third party software providers whose software happened to be used by Mr Scott's accountants in preparing his returns. In relation to the returns themselves, HMRC has done nothing.

185. For all of these reasons, I reject the Mr Scott's arguments on the procedural issue.

DECISION

186. In my view, the answers to the questions before the Tribunal are as follows:

(1) for the tax year 2006/07, the amount of the deduction referred to in section 6(2)(a) TCGA can be an amount up to the full amount of the deficiency, but that the reduction required by section 6(2) to the income of a person cannot reduce the total income of that person to a negative figure (for the purposes of computing the unused part of an individual's basic rate band in section 4(4) TCGA);

(2) for the tax year 2007/08, the amount of the deduction referred to in section 6(2)(a) TCGA can be an amount up to the full amount of the deficiency, but that the reduction required by section 6(2) to the Step 3 income of a person cannot reduce the Step 3 income of that person to a negative figure (for the purposes of computing the unused part of an individual's basic rate band in section 4(4) TCGA);

(3) the Tribunal does have jurisdiction to determine whether HMRC was entitled under section 9A TMA to enquire into the calculations of tax due in Mr Scott's tax returns for the tax years in question;

(4) HMRC was entitled under section 9A TMA to enquire into the calculations of tax due in Mr Scott's tax returns for the tax years in question and so the amendments made by the closure notices were valid.

187. I assume that my decision on these issues will enable the parties to finalize the amounts of tax payable by Mr Scott in the years in question. If that proves not to be possible, the parties may reapply to the Tribunal.

Rights of appeal

188. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ASHLEY GREENBANK
TRIBUNAL JUDGE

RELEASE DATE: 4 MAY 2017

APPENDIX 1

STATEMENT OF AGREED FACTS

1. Mr Scott claimed corresponding deficiency relief ("CDR") under ITTOIA 2005, s.539 of £20,212,917 for 2006/07 and £22,613,114 for 2007/08. He was entitled to this relief and in these amounts.

2. Mr Scott's accountants were (and are) Saffery Champness. They used a software package supplied by a third party to produce Mr Scott's self-assessment ("SA") income and capital gains Tax Returns for both years, including the calculation of tax due.

3. HMRC provided technical specifications for the SA third party online software developers that included the specifications for the SA tax calculation in HMRC's systems, a list of cases which might require special consideration ("Specials") and a list of cases which were not appropriate for automated processing online ("Exclusions"). If the third party software was developed in accordance with that information then it is likely to have functioned in the same way as HMRC's systems.

4 If a taxpayer had attempted to submit a tax return including a calculation that did not agree with HMRC's systems' calculation, the attempted submission would have been rejected by HMRC's systems. This would have included the SA's tax calculation summary, in which the taxpayer sets out his liability under the different heads of tax, including income tax and capital gains tax, as well as his National Insurance contribution and certain other pieces of information. If the calculation did not agree with HMRC's systems', the taxpayer would have had either to revise the return or to obtain from their software provider or HMRC a "workaround" to complete the entries in the online return differently from what was prescribed (or file a paper return). (The word "workaround" indicates a practical solution to an IT problem which would otherwise prevent an electronic document or return being filed or filed accurately.)

5. For 2006/07 and 2007/08 the SA tax calculator specifications extended the basic rate band when seeking to calculate tax due as a result of CDR. For all years up to and including 2009/10 HMRC's system's calculators worked in the same way.

2006/07 Tax Return

6. Mr Scott was given notice to file a 2006/07 Tax Return under s8 TMA on 6 April 2007. Such a return was required to include a self-assessment under s9 TMA 1970. The time limit for the filing that return was: 31 January 2008 if Mr Scott was to file his Tax Return online.

7. Saffery Champness attempted but were unable to submit Mr Scott's Tax Return to HMRC electronically because of problems with HMRC's computers on 31 January 2008. Instead, the same return was filed in paper form. The tax calculation was performed by the third party software using specifications which extended the basic rate band when seeking to calculate tax due as a result of CDR.

8. The summary of Mr Scott's 2006/07 return of income and gains and self-assessment was as follows:

Pay from employments less expenses:		£ 15,058
Profit from self-employment:		£ 8,450
Profit from partnerships:		£ 6,157
Profit from UK land and property:		£ 78,888
Foreign income:		£ 1,158
Income from Trusts and Estates:		£ 1,827,038
Interest from UK banks & building societies:		£ 43,944
Dividends from UK companies (plus 10% tax credit):		£ 606,507
Gains on life insurance policies:		£41,300,247
Other income:		£ 680,909
Total income:		**£44,568,356**
Less:		
Losses:	£ 760,738	
Loan interest payments:	£ 1,930	
Personal allowance:	£ 5,035	(£ 767,703)
Total income on which tax was due:		**£43,800,653**
The income tax charge on the above income was:		**£13,227,417.54 ***
Less:		
Top slicing relief:	£4,710,887.20	
Enterprise Investment relief:	£ 80,000.00	
Life policy notional tax:	£8,260,049.40	
Foreign Tax credit relief:	£ 65.00	(£13,051,001.60)

Income Tax due after allowances and reliefs:	**£ 176,415.94**
Less:	
10% tax credits on dividends from UK companies:	(£ 243,269.50)
Income Tax due:	**0.00**

*** reflecting the fact that the basic rate band had been extended by £20,212,917 for CDR and £1,924 for gift aid payments**

Taxable gains minus the annual exemption of £8,800:	£8,865,463.00
Capital gains tax due @ 20%:	**£1,773,092.60**

9. To allow HMRC to process the 2006/07 Tax Return, it was corrected by HMRC under s 9ZB TMA 1970 which allows HMRC to correct "obvious errors or omissions in a return". This power is separate from the right to enquire into the return under s9A TMA 1970 and to the power to close enquiries. HMRC made a number of corrections to the return which are detailed in the document, but they do not concern any issues in the case and other than the correction of those mistakes, the taxpayer's returned self-assessment remained intact.

10. The letter which effected the correction, dated 14 May 2008, stated:

> "This tax calculation is based on figures in your Tax Return before it has been checked. It is not our confirmation that your return is complete and correct. If, at a later date, your return is found to be incorrect, your tax calculation will be amended accordingly".

11. The time limit for opening an enquiry into the 2006/07 Tax Return, as given by s 9A(2)(a) TMA 1970 was twelve months after the filing date i.e. 30 January 2009. An enquiry into the 2006/07 Tax Return was opened within the time limit allowed, on 8 January 2009.

12. Although HMRC ultimately accepted that the arrangements adopted worked so as to reduce Mr Scott's 2006/07 income tax liability to £4,623.48, HMRC did not agree that the claim to CDR meant that the ultimate gains of £8,844,541 should be taxed at the rate of 20% instead of the rate of 40%. This point was first referred to in HMRC's letter of 27 July 2012 (in relation to the 2007/08 enquiry), which stated:

> "I also need to be satisfied that the legislation intends for corresponding deficiency relief to be available to reduce the capital gains tax rate, as suggested by Mr Scott's 2008 Return."

13. The enquiry into the 2006/07 Return was closed under s 28A(1) and (2) TMA 1970, by a Closure Notice issued to Mr Scott on 13 February 2015. Full details of the significant number of adjustments made to the Return, as a consequence of the enquiry, are set out in that Closure Notice. HMRC concluded that the final taxable capital gains of £8,844,541 should be taxed at the rate of 40% and not 20%.

2007/08 Tax Return

14. Mr Scott was given notice to file a 2007/08 Tax Return under s 8 TMA 1970 on 7 April 2008. Such a return was required to include a self-assessment under s9 TMA 1970. The time limit given for the filing of that return was: 31 October 2008 if Mr Scott was to send a paper Tax Return, or 31 January 2009 if Mr Scott was to file his Tax Return online.

15. Saffery Champness filed Mr Scott's SA Tax Return for 2007/08 electronically on 30 January 2009. The tax calculation in the return was made using the specifications which extended the basic rate band when seeking to calculate tax due as a result of CDR. The return used a workaround under "Exclusion 26" (unrelated to CDR and separate to the legal issue in this appeal).

16. The summary of Mr Scott's 2007/08 Return of income and gains and self-assessment was as follows:

Pay from employments less expenses:			£	8,660
Profit from self-employment:			£	2,934
Profit from partnerships:			£	74,185
Profit from UK land and property:			£	91,029
Foreign income:			£	374,755
Income from Trusts and Estates:			£	213,998
Interest from UK banks & building societies:			£	138,102
Dividends from UK companies (plus 10% tax credit):			£	7,119,062
Gains on life insurance policies:			£	13,863
Other income:			£	387,573
Total income:			**£**	**8,424,161**
Less:				
Losses:	£	619,150		

Loan interest payments:	£ 2,146	
Personal allowance:	£ 5,225	(£ 626,521)
Total income on which tax was due:		**£ 7,797,640**
The income tax charge on the above income was:		**£828,314.26 ***
Less:		
Enterprise Investment relief:	£ 80,000.00	
Life policy notional tax:	£ 2,772.60	(£ 82,772.60)
Income Tax due after allowances and reliefs:		**£ 745,541.66**
Less:		
10% tax credits on dividends from UK companies:		(£ 733,373.00)
Income Tax due:		**£ 12,170.88**

*** reflecting the fact that the basic rate band had been extended by £22,613,114 for CDR and £642,949 for gift aid payments**

Taxable gains minus the annual exemption of £9,200	£ 15,922,215
Capital gains tax due (£15,493,023 @ 20%):	**£ 3,098,604.60**
Capital gains tax due (£429,192 @ 40%):	**£ 171,676.80**
Total capital gains tax due:	**£ 3,270,281.60**

17. The time limit for opening an enquiry into the 2007/08 Tax Return, as given by s9A(2)(a) TMA 1970 was twelve months after the day the return was delivered i.e. 30 January 2010. An enquiry into the 2007/08 Return was opened within the time limit allowed, on 20 January 2010.

18. Although HMRC ultimately accepted that the arrangements adopted worked so as to reduce Mr Scott's 2007/08 Income Tax liability to £49,625.12, HMRC did not agree that the claim to CDR meant that the ultimate gains of £14,713,593 should be taxed at the rate of 20% instead of the rate of 40%. This point was first referred to in HMRC's letter of 27 July 2012, as described in more detail at 12 above.

19. The enquiry into the 2007/08 Return was closed under s 28A(1) and (2) TMA 1970, by a Closure Notice issued to Mr Scott on 13 February 2015. Full details of the significant number of adjustments made to the Return, as a consequence of the enquiry, are set out in that Closure Notice. HMRC concluded that the final taxable capital gains of £14,713,593 should be taxed at the rate of 40% and not 20%.

APPENDIX 2

Legislation in force in the tax year 1988/89

Finance Act 1988

98. Rates of capital gains tax

(1) Subject to the provisions of this section and sections 99 and 100 below, the rate of capital gains tax in respect of gains accruing to a person in a year of assessment shall be equivalent to the basic rate of income tax for the year.

(2) If income tax is chargeable at the higher rate in respect of any part of the income of an individual for a year of assessment, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the higher rate.

(3) If no income tax is chargeable at the higher rate in respect of the income of an individual for a year of assessment, but the amount on which he is chargeable to capital gains tax exceeds the unused part of his basic rate band, the rate of capital gains tax on the excess shall be equivalent to the higher rate of income tax for the year.

(4) The reference in subsection (3) above to the unused part of an individual's basic rate band is a reference to the amount by which the basic rate limit exceeds his total income (as reduced by any deductions made in accordance with the Income Tax Acts).

102. Other special cases.

(1) …

(2) Where for any year of assessment—

[...]

(b) by virtue of section 549(2) of that Act (gains under life policy or life annuity contract) a deduction of an amount is made from a person's total income for those purposes,

[…]

section 98(4) above shall have effect as if his income for the year were reduced by that amount.

…

Income and Corporation Taxes Act 1988

549. Certain deficiencies allowable as deductions.

(1) Subject to subsection (2) below, where such an excess as is mentioned in section 541(1)(a) or (b) or 543(1)(a)—

(a) would be treated as a gain arising in connection with a policy or contract, and

(b) would form part of an individual's total income for the year of assessment in which the final year ends,

a corresponding deficiency occurring at the end of the final year shall be allowable as a deduction from his total income for that year of assessment, so far as it does not exceed the total amount treated as a gain by virtue of section 541(1)(d) or 543(1)(c) on the previous happenings of chargeable events.

(2) Except where the deficiency mentioned in subsection (1) above occurs in connection with a contract for a life annuity made after 26th March 1974, the deduction allowable under that subsection shall be made only for the purposes of ascertaining the individual's excess liability, that is to say, the excess (if any) of his liability to income tax over what it would be if all income tax were chargeable at the basic rate to the exclusion of any higher rate.

(3) In this section "final year" has the same meaning as in section 546.