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Cotter: When is a return not a return?

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What is a tax return?

One cannot imagine a question much more fundamental to the self-assessment regime, so it is surprising that it took the Supreme Court to answer it, in *Cotter v HMRC* [2013] UKSC 69, and more surprising that the answer remains 'it depends'.

What was the context?

Mr Cotter claimed, through participation in a tax avoidance scheme, to have sustained a substantial loss for income tax purposes in 2008/09, which he claimed to 'carry back' against income of 2007/08. The question before the court was not whether the scheme worked: rather, it had to consider the machinery for claiming the relief and, specifically, whether tax had to be paid pending resolution of HMRC's enquiries into the validity of the claim. Mr Cotter's is a test case; but the decision is of wide application in relation to any claim which involves carrying back a relief to an earlier tax year.

Why did it matter?

If a claim is made by being included in a tax return, it may be challenged by HMRC only via an enquiry into the return under TMA 1970 s 9A. At the closure of the enquiry, further tax (together with interest) may become payable, but during the course of the enquiry the amount of tax payable generally remains that disclosed by the self-assessment. By contrast, if a claim is made otherwise than by being included in a tax return (a 'free-standing claim'), any enquiry into it is governed by TMA 1970 Sch 1A and HMRC is empowered, on enquiring into the claim, to decline to give it effect until the enquiry is concluded.

What were the competing arguments?

It was accepted by both sides that the claim was governed by TMA 1970 Sch 1B para 2. This provides that where a claim involves a 'carry-back' of a loss or expense, the claim, albeit quantified by reference to the earlier year, does not affect the tax payable for the earlier year and is to be treated as a claim for, and given effect in relation to, the later year. It was thus agreed that, on any analysis, the claim did not affect the tax payable for 2007/08.

HMRC therefore concluded that the claim, being irrelevant to the tax liability for 2007/08, could not be regarded as included in the tax return for that year, and was therefore a 'free-standing' claim to which Sch 1A applied.

The taxpayer's contrary argument was, in the words of the Supreme Court, 'attractive in its simplicity'. Schedule 1A applied only to 'claims made otherwise than by being included in a return'; there was a box on the 2007/08 tax return headed 'relief now for 2008/09 trading or certain capital losses', and the loss was in fact entered in that box. The claim was, therefore, as a matter of simple fact 'included in the 2007/08 return', and as a result Sch 1A could not apply and any enquiry could be made only under s 9A.

What was decided?

Effectively, the Supreme Court decided that a carried-back loss claim is or is not part of a taxpayer's return, according to whether the tax return does or does not include the taxpayer's own self-assessment of tax payable. If the return does include such a self-assessment which takes account of the claim the self-assessment (and therefore the claim) is part of the return; it can be challenged by HMRC only by amending the return under s 9B (which amendment could of course be rejected by the taxpayer) or by enquiring into it under s 9A. But if a taxpayer chooses to let HMRC calculate the tax due, HMRC may ignore any claim which (although physically part of the return) is clearly not relevant to the calculation of tax for the year and treat it as a free-standing claim susceptible to enquiry under Sch 1A.

What are the implications?

At first glance, the decision allows a determined tax avoider to delay payment of tax in carry-back cases by self-assessing his liability so as to put himself outside Sch 1A, and then sitting back while the substantive test case trundles through the courts. But further thought shows that this is not so. The carry-back claim will certainly not affect the liability for the earlier year: any self-assessment which is made on the basis that it does will be manifestly wrong (and even potentially negligent or worse). Any appeal against a closure notice for the earlier year would be doomed to certain failure, regardless of the substantive merits of the underlying loss claim. And whether, having included the carry-back claim in the return for the earlier year and (inevitably) lost before the tribunal, the taxpayer could then have a second bite of the cherry by making an identical free-standing claim for the same amount, must be open to some doubt. So the Supreme Court decision, which at first looks like a 'Get out of jail free' card may actually turn out to be closer to 'Do not pass go'.

Where now?

A solution is hinted at in the closing paragraphs of the Supreme Court decision. There, it is suggested that it would be open to HMRC to amend the design of the return form so as to make it clear which parts of it request information relevant to the calculation of tax for the relevant year (and are therefore part of the return form proper) and which parts merely provide for the intimation of 'free-standing' claims. For many reasons, the sooner HMRC takes the hint, the better.