Kavanagh: tax settlement warning as De Silva case looms

Tax settlements with HMRC may not yield the best results for taxpayers in dispute, warns John Kavanagh, senior counsel at Taxxa, as the potentially decisive De Silva case approaches the Supreme Court in 2017

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Although there has been a great deal of litigation regarding tax avoidance arrangements in recent years, many cases have not yet reached the courts. HMRC is keen to settle those cases, preferably without litigation and collect the tax.

In last year's Autumn Statement, the government announced further 'settlement opportunities' for taxpayers and some settlements have already been reached. However, settling with HMRC could result in some paying far more tax than they may ultimately owe.

Settlements with HMRC frequently take the form of binding legal contracts. This means that, even if judicial interpretation of the relevant tax law changes after the contract is signed, the settlement's terms remain in force, unless the parties agree to vary them or a court orders otherwise, and there is no guarantee that either of those things would happen.

The De Silva judicial review

Next year, the Supreme Court will hear an appeal in a judicial review case, *The Queen (on the application of De Silva and another) v Commissioners of Revenue and Customs (http://www.bailii.org/ew/cases/EWCA/Civ/2016/40.html)*[2016] EWCA Civ 40 (http://www.bailii.org/ew/cases/EWCA/Civ/2016/40.html). This is one of three cases involving members of the Cotter Solutions Action Group, the others being *The Queen (on the application of) Derry v Revenue and Custom* [2015] UKUT 416 (TCC) (http://www.bailii.org/uk/cases/UKUT/TCC/2015/416.html) and *Dr Walapu v HMRC* [2016] EWHC 658 (http://www.bailii.org/ew/cases/EWHC/Admin/2016/658.html).

Although the claimants in De Silva were users of the 'Liberty' tax avoidance scheme marketed by Mercury Tax Group, the outcome of the case could mean that taxpayers who made carry-back claims would retain the benefit of those claims, even if the scheme or arrangement has been successfully challenged by HMRC. It is those taxpayers who are most likely to be contemplating settlements with HMRC now, possibly to their ultimate detriment.

The relevance of the Cotter case

The point at issue in De Silva is a technical one, namely whether HMRC has enquired correctly into stand-alone claims: i.e. claims not included in a return. HMRC argues in De Silva that an enquiry into a return under section 9A TMA 1970 extends to any claim included in that return, and where there is a claim for a partnership loss, any reduction to the partnership losses as a consequence of an enquiry at partnership level flows through to the individual partners' returns. This is probably an interpretation that most advisers would have accepted until recently.

However, the claimants rely on what they consider to be a clear statement of the law in another Supreme Court case, *Cotter v HMRC* [2013] STC 2480 (http://www.bailii.org/uk/cases/UKSC/2013/69.html). The Supreme Court found that a stand-alone claim is not included in a return for a year just because its details are entered on the return form. The De Silva claimants argue that this means that an enquiry under section 9A TMA 1970 is not a valid enquiry into a stand-alone claim. In Cotter, HMRC's power to enquire into a claim under Schedule 1A TMA 1970 worked to its advantage as it meant that they could collect the disputed tax immediately whereas if it was the subject of a section 9A enquiry, it could not be collected until that enquiry was concluded.

However, the claimants in De Silva seek to use Cotter to argue that, as HMRC did not make timely enquiries under Schedule 1A TMA 1970, their stand-alone claims are final and conclusive, even though the Liberty losses were disallowed at partnership level. HMRC argues that the Cotter decision is relevant only to the particular facts of that case and that the scheme of partnership enquiries is such that any amendment to a partnership return must flow through to each partner's return. The Supreme Court will decide the matter next year.

Proceed with caution

HMRC does not seem to admit the possibility that they will lose in De Silva and they are certainly not bringing this important case to the attention of those taxpayers they are inviting to settle.

Individuals whose tax affairs could be affected by the outcome of De Silva would be wise to resist any temptation to enter into settlements with HMRC unless and until HMRC accept that they can be revisited in the event that the claimants win in De Silva. Otherwise, they may find themselves tied into agreements that require them to pay more tax than may be legally due or having to take HMRC to court to have the agreement varied or set aside, with outcomes that are by no means certain.

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