TC08066

INCOME TAX – carried forward property business losses – whether applied in priority to personal allowance in subsequent tax years – whether HMRC correct to have opened an enquiry under s9A TMA 1970 or if enquiry should have been opened under Schedule 1A – held enquiry had been validly opened and no carried forward property business losses available as they had been used in prior years – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/08845

BETWEEN

SARAH DUNCAN **Appellant**

-and-

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

TRIBUNAL: JUDGE JEANETTE ZAMAN

The hearing took place on 16 March 2021. With the consent of the parties, the form of the hearing was a remote video hearing on the Tribunal video platform. A face to face hearing was not held because of the ongoing restrictions resulting from the COVID-19 pandemic. The documents to which I was referred are described in the decision notice.

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Jonathan Vyse, Pearl Lily & Co Accountants, for the Appellant

Harry Robison, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION AND SUMMARY

1. Ms Duncan has appealed against a closure notice issued by HMRC on 24 July 2019 for the tax year 2017-2018 which amends her self-assessment for that year, increasing her tax liability by an additional £1,083.50. Ms Duncan's return had claimed the use of a brought forward loss of £6,017. HMRC denies that such loss is available, contending that it has been used in previous tax years.

2. Mr Vyse submitted that the approach taken by HMRC is not fair to taxpayers on low incomes, as it forces them to waste their losses in years in which their income would otherwise have been fully sheltered by their personal allowance. He put two (alternative) arguments which I set out more fully below, but essentially he challenged whether HMRC had validly opened an enquiry and submitted that Ms Duncan's personal allowance should have been used in priority to the carried forward loss in prior years such that the loss remained available for use in the tax year 2017-2018.

3. Ms Duncan gave notice of appeal to the Tribunal on 11 November 2019. HMRC's review conclusion letter had been dated 9 October 2019. The appeal to the Tribunal was therefore made a couple of days late. HMRC did not make any objection to the lateness of the appeal, either in their Statement of Case or at the hearing, and having regarding to the overriding objective in rule 2 of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 I decided to admit the appeal.

4. Having heard the submissions of both parties, and for the reasons set out below, I have dismissed Ms Duncan's appeal. HMRC had validly opened an enquiry into her return and the legislation is clear that carried forward property losses must be applied before (or in priority to) the personal allowance, the consequence of which is that the losses had been exhausted in prior tax years and were not available for use in the year under appeal.

BACKGROUND FACTS

5. There was no disagreement between the parties as to the facts set out below.

6. Ms Duncan submitted her return for the tax year 2017-2018 on 21 January 2019. The tax return form included a loss brought forward of £6,017.

7. The position for prior tax years was that:

   (1) Ms Duncan had realised losses of £14,493 in 2007-08, £1,895 in 2008-2009 and £678 in 2012-13.

   (2) Ms Duncan had realised net profits of £5,037 in 2009-2010, £969 in 2010-2011, £3,001 in 2011-2012, £7,056 in 2013-2014, £4,992 in 2014-2015, £2,277 in 2015-2016 and £2,132 in 2016-2017.

8. On 21 February 2019 HMRC gave notice of an enquiry under s9A Taxes Management Act 1970 ("TMA 1970") into the 2017-18 return, indicating that they were looking into the use of the losses.

9. On 28 June 2019 HMRC sent a revised tax calculation showing additional tax of £1,805.10. HMRC's position was that all of the losses previously realised had been used in prior tax years. After further correspondence, by the time HMRC issued the closure notice on 24 July 2019 that additional tax due was reduced to £1,083.50, reflecting the inclusion of relief for 25% of interest costs for the year.

10. There was no dispute as to quantum – Ms Duncan agreed that if she is unsuccessful on both of her grounds of appeal then the amendments made by HMRC in the closure notice would be correct.

PAPERS

11. I had a hearing bundle of 365 pages as well as a bundle of authorities.

12. That hearing bundle included what was said to be a witness statement from Jonathan Vyse dated 18 December 2020. That witness statement addressed the submission of Ms Duncan's return and the approach he had taken thereto, as well as stating his opinion that it is "against natural justice and against the avowed progressive nature and fairness of the tax system, that taxpayers with the lowest incomes should be forced to waste losses when those with higher incomes are not". At the hearing I raised the point that this was not a witness statement addressing matters of fact in issue in this appeal. Mr Vyse agreed, explaining that he had prepared this statement (to which he had attached his written representations in this appeal) in case there was a difficulty with him being able to represent Ms Duncan at the hearing if she were not herself attending. Ms Duncan was present at the hearing. I saw no difficulty with her being represented by Mr Vyse.

13. I stated that I would treat both his witness statement and the written representations as submissions on behalf of Ms Duncan, and was satisfied that Mr Vyse could represent Ms Duncan at the hearing. He would be speaking as her representative, and not as a witness of fact, which meant that he would not be cross-examined by Mr Robison.

RELEVANT LEGISLATION

14. The relevant provisions of TMA 1970 in relation to enquiries are:

> "**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.
>
> ...
>
> (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.
>
> (5) If the notice of enquiry is given as a result of an amendment of the return under section 9ZA of this Act—
>
> (a) at a time when it is no longer possible to give notice of enquiry under subsection (2)(a) or (b) above, …
>
> (b) after a final closure notice has been issued in relation to an enquiry into the return, or

(c) after a partial closure notice has been issued in such an enquiry in relation to the matters to which the amendment relates or which are affected by the amendment,

the enquiry into the return is limited to matters to which the amendment relates or which are affected by the amendment.

(6) In this section “the filing date” means, in relation to a return, the last day for delivering it in accordance with section 8 or 8A.

…

42 Procedure for making claims etc.

(1) Where any provision of the Taxes Acts provides for relief to be given, or any other thing to be done, on the making of a claim, this section shall, unless otherwise provided, have effect in relation to the claim.

(1A) Subject to subsection (3) below, a claim for a relief, an allowance or a repayment of tax shall be for an amount which is quantified at the time when the claim is made.

(2) Subject to subsections (3) to (3ZC) below, where notice has been given under section 8, 8A or 12AA of this Act, a claim shall not at any time be made otherwise than by being included in a return under that section if it could, at that or any subsequent time, be made by being so included.

…

(5) The reference in this section to a claim being included in a return include references to a claim being so included by virtue of an amendment of the return.

…

(10) This section (except subsection (1A) above and subject to subsection (10A) below) shall apply in relation to any elections as it applies in relation to claims.

…

(11) Schedule 1A to this Act shall apply as respects any claim or election which—

(a) is made otherwise than by being included in a return under section 8, 8A, 12ZB or 12AA of this Act,

…

(11A) Schedule 1B to this Act shall have effect as respects certain claims for relief involving two or more years of assessment.

(13) In this section 'profits' —

(a) in relation to income tax, means income, and

(b) in relation to capital gains tax, means chargeable gains.

…

Schedule 1A

1.

In this Schedule—

'claim' means a claim or election as respects which this Schedule applies;

…

4.

(1) Subject to sub-paragraphs (1A), (3) to (5) below, an officer of the Board or the Board shall, as soon as practicable after a claim other than a partnership claim is made, or such a claim is amended under paragraph 3 above, give effect to the claim or amendment by discharge or repayment of tax.

...

(3) Where any such claim or amendment as is mentioned in sub-paragraph (1) or (2) above is enquired into by an officer of the Board—

(a) that sub-paragraph shall not apply until the day on which, by virtue of paragraph 7(1) below, the enquiry is completed; but

(b) the officer may at any time before that day give effect to the claim or amendment, on a provisional basis, to such extent as he thinks fit.

(4) Nothing in this paragraph applies in relation to a claim or an amendment of a claim if the claim is not one for discharge or repayment of tax.

(5) This paragraph has effect subject to any provision in the Taxes Acts that—

(a) requires or allows effect to be given to a claim by other means, or

(b) provides that an amount is not to be discharged or repaid.

5.

(1) An officer of the Board may enquire into—

(a) a claim made by any person, or

(b) any amendment made by any person of a claim made by him,

if, before the end of the period mentioned in sub-paragraph (2) below, he gives notice in writing of his intention to do so to that person or, in the case of a partnership claim, any successor of that person.

…"

15. The relevant provisions of Income Tax Act 2007 ("ITA 2007") are:

"**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 sections 24A and 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 … (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. See also section 863I of ITTOIA 2005 which provides for certain partnership profits to be charged at the additional rate.

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.

24 Reliefs deductible at Step 2

(1) If the taxpayer is an individual, the provisions referred to at Step 2 of the calculation in section 23 are -

…

(b) the following-

…

section 118 (carry-forward property loss relief),

section 120 (property loss relief against general income), section 125 (post-cessation property relief),

section 128 (employment loss relief against general income),

section 152 (loss relief against miscellaneous income),

Chapter 1 of Part 8 (interest payments),

…

25 Reliefs and allowances deductible at Steps 2 and 3: supplementary

(1) This section supplements the provisions about reliefs and allowances in Steps 2 and 3 of the calculation in section 23.

(2) At Steps 2 and 3, deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax.

(3) Subsection (2) is subject to—

section 65(2) to (4) (priority rule in relation to trade loss relief against general income),

section 80(2) (ring fence income),

section 83(3) and (4) (carry-forward trade loss relief against trade profits),

section 89(3) (terminal trade loss relief against trade profits),

section 93(2) (terminal trade loss relief and mineral extraction trade),

section 95(2) (foreign trades etc reliefs only against qualifying foreign income),

section 115(2) (restrictions on reliefs for firms exploiting films),

section 118(3) and (4) (carry-forward property loss relief against property business profits),

section 121(2) and (3) (priority rule in relation to property loss relief against general income),

…, and

any other provision of the Income Tax Acts under which reliefs or allowances deductible at Step 2 or 3 are not permitted to be deducted from particular components of income or are required to be deducted from particular components of income or in a different order.

(4) A relief or allowance may be deducted at Step 2 or 3 only so far as there is sufficient income from which to deduct it.

(5) In deciding whether there is sufficient income from which to deduct a relief or allowance, reliefs and allowances already deducted at Step 2 or 3 must be taken into account.

(6) Nothing in Step 2 or 3 is to be read as permitting a relief or allowance to be deducted more than once.

…

27 Order of deducting tax reductions: individuals

(1) This section makes provision about the order in which tax reductions are to be deducted at Step 6 of the calculation in section 23, if the taxpayer is an individual.

(2) Deduct the tax reductions in the order which will result in the greatest reduction in the taxpayer's liability to income tax for the tax year.

(3) Subsection (2) is subject to subsections (4) to (6).

(4) If the taxpayer is entitled to tax reductions for the tax year under more than one of the provisions listed in subsection (5), a tax reduction under a provision mentioned earlier in the list must be deducted before a tax reduction under a provision mentioned later in the list.

(5) The provisions are–

Chapter 2 of Part 6 (VCT relief),

Chapter 1 of Part 5 (EIS relief),

Chapter 1 of Part 5A (SEIS relief),

Chapter 1 of Part 5B (relief for social investments),

Chapter 1 of Part 7 (community investment tax relief),

section 353(1A) of ICTA (relief for interest on loan to buy life annuity),

section 453 (qualifying maintenance payments),

Chapter 3 of Part 3 of this Act (tax reductions for married couples and civil partners).

(6) If the taxpayer is entitled to a tax reduction under–

(a) sections 2 and 6 of TIOPA 2010 (double taxation arrangements: relief by agreement), or

(b) section 18(1)(b) and (2) of TIOPA 2010 (relief for foreign tax where no double taxation arrangements),

that tax reduction must be deducted after any other tax reduction to which the taxpayer is entitled for the tax year.

…

118 Carry forward against subsequent property business profits

(1) Relief is given to a person under this section if the person—

(a) carries on a UK property business or overseas property business (alone or in partnership) in a tax year, and

(b) makes a loss in the business in the tax year.

(2) The relief is given by deducting the loss in calculating the person's net income for subsequent tax years (see Step 2 of the calculation in section 23).

(3) But a deduction for that purpose is to be made only from profits of the business.

(4) In calculating a person's net income for a tax year, deductions under this section from the profits of a business are to be made before deductions of any other reliefs from those profits.

(5) No relief is to be given under this section so far as relief for the loss is given under section 120.

(6) This section needs to be read with section 119 (how relief works).

119 How relief works

This section explains how the deductions are to be made.

The amount of the loss to be deducted at any step is limited in accordance with section 25(4) and (5).

Step 1 Deduct the loss from the profits of the business for the next tax year.

Step 2 Deduct from the profits of the business for the following tax year the amount of the loss not previously deducted.

Step 3 Continue to apply Step 2 in relation to the profits of the business for subsequent tax years until all the loss is deducted."

APPELLANT'S SUBMISSIONS

16. Mr Vyse put forward two alternative arguments, both of which had been set out as grounds of appeal. His submissions were careful and detailed. The summary below is exactly that; a summary, rather than a full rehearsal of all the arguments that were put. I have, however, taken his more detailed arguments into account in reaching my decision.

17. Mr Vyse submitted that when calculating a taxpayer's tax liability s25(2) ITA 2007, which states "[a]t Steps 2 and 3, deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax", places an obligation on HMRC to interpret the use of reliefs in a generous fashion and that the phrase "in the way" extends beyond the ordering of usage of reliefs and allowances to include whether the relief is used or not or used as a nil deduction (ie whether the carried-forward losses are used at all in a prior year). There is a question as to whether property losses must be wasted in the presence of an unused personal allowance.

18. Mr Vyse supported this submission with detailed arguments as to the correct or permissible approach to interpretation of s23 and the provisions related to computation:

(1) The Broadest Interpretation Issue – an income tax calculation must "result in the greatest reduction in the taxpayer's liability to income tax". This phrasing, that the approach must be in the taxpayer's favour, embedded in the statutory language, is very unusual and regard must be had to this. The legislation does not expressly require that Step 2 must be undertaken before Step 3 (in contrast to the ordering set out in s27), s25 deals with Steps 2 and 3 together, illustrating the principle that there is no requirement that one calculation is performed in priority to the other and s25(6) prohibits double-counting, but does not require that a particular relief must be used only that it must not be used more than once.

(2) The Precedence versus Temporal Steps in Calculation of Income Tax Liability Issue – the calculation of an income tax liability is not ordered in time (temporally), merely ordered in precedence in the usual arithmetic way, with consequences for interpretation of income tax liability. The fact that s23 sets out the steps required to calculate the income tax liability in a certain order does not require that such steps must be performed in that sequence – this can be seen by reference to US patent law. In statute, there is no inherent requirement that a provision at, eg, s3 of an Act, would take priority to a condition in s43 in the absence of any express provision to that effect, and in the present context no such provision should be implied. The use of text rather than formulae to set out what is essentially a mathematical calculation is less precise, but should not be read as requiring that steps are performed in the order in which they are set out.

(3) The "In the Way" Interpretation Issue – "in the way" in s25(2) means an exhaustive search of all valid ways is to be performed when undertaking "the calculation of income tax liability", that is all ways that are not expressly prohibited, and with the taxpayer having the choice of which "way" to use where multiple "ways" exist.

(4) The Greatest Reduction Antecedent Issue – the reference to "the taxpayer's liability to income tax" is not qualified by reference to that particular tax year, unlike in s23 which does so refer. Thus, when assessing the approach which gives the greatest reduction, that exercise is to be undertaken by considering all tax years for that taxpayer – past, present and future.

(5) The Sufficient Income from Which to Deduct Issue – the temporal freedom available in "the calculation of income tax liability" may result in the exhaustion of "sufficient income from which to deduct" at any step in "the calculation of income tax liability", calculated at any time, and in the usual arithmetic way. If the deduction of any relief or any allowance at Step 2 or 3 (taken in any order) reduces the remaining income to nil, then there is no longer any "sufficient income" from which to deduct other entitlements. Therefore, if the taxpayer is entitled to a personal allowance and chooses to use that allowance and has total income of less than that amount then everywhere else in the calculation the "sufficient income" does not exist. That occurs here; the deduction of the personal allowance does not leave "sufficient income".

(6) The How Relief Works Issue – when determining "how deductions are to be made" under s119 for carry-forward property loss relief, rather than when undertaking "the calculation of income tax liability", the deductions remain bound by the interpretation of "the calculation of income tax liability". Where "sufficient income" does not exist in the "subsequent tax years" in s118(2) (as the personal allowance has been applied), then in such years the amount of loss to be deducted at any step in those years under s119 is nil.

19. Mr Vyse submitted in the alternative that HMRC had not validly enquired into the use of the carry-forward property loss in 2017-2018. The claim to use such loss in 2017-2018 is not made in the tax return for the year of use (there being a distinction, acknowledged by the Supreme Court in *Cotter*, between the tax return and the information on a tax return form), but rather the claim is made in an earlier tax year, the year of loss, and is therefore a claim made otherwise than in the return in the year of use. The opening of an enquiry under s9A TMA 1970 was therefore the wrong procedural route by which to challenge the position taken by Ms Duncan to the use of the losses for the year under appeal.

HMRC'S SUBMISSIONS

20. HMRC's position can be summarised as follows. Mr Robison submitted that there were no property losses brought forward as at 6 April 2017. These had been offset against property income in earlier years - these losses had been used in 2009-2010, 2010-2011, 2011-2012, 2013-2014 and the last £1,003 in 2014-2015.

21. Mr Robison submitted that the numbered steps set out in s23 ITA 2007 had to be followed and applied in sequence:

> (1) Section 118 sets out the rules for carrying forward losses against subsequent property business profits. Section 118(4) says that "in calculating a person's net income for a tax year, deductions under this Section from the profits of a business are to be made before deductions of any other reliefs from those profits." Other reliefs include personal allowances.
>
> (2) In applying s118 consideration has to be given to s23 which sets out how a person's liability to tax is calculated, as well as s24 and s25 which set out the reliefs which are deductible when calculating income tax liability and when to deduct them.
>
> (3) At Step 2 of s23, a property loss brought forward under s118 should be deducted from the profits of Ms Duncan's same property business prior to other reliefs. This includes personal allowances, which are only deducted at Step 3 of the calculation in accordance with s23. Step 3 itself refers to amounts being deducted "after step 2".
>
> (4) At Steps 3 and 4 of s118, the legislation sets out that the same order is applied when calculating a person's net income for a tax year in relation to reliefs. Furthermore, in accordance with s25(3), s25(2) is subject to s118(3) and s118(4).

22. The legislation does not suggest a flexibility in whether it is applied or not. Although s25(2) does provide for the taxpayer to apply the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax, this is still subject to the specific rules as set out in s118(4) to deduct losses before utilising the taxpayer's personal allowances. In the present instance, there is only one way to treat the carried forward loss and that is as set out in s118 and s119. Section 25(2) cannot be looked at in isolation, but regard must be given to s25 in its entirety in conjunction with s23.

23. Mr Robison also submitted that HMRC had correctly opened an enquiry under s9A TMA 1970. HMRC recognise that *Cotter* is the leading authority in this area but submit that it is not relevant in this case - in *Cotter*, the appellant had wanted to carry a loss back to an earlier year and made a claim for the loss in the earlier year's return. In this case, Ms Duncan included the loss of £6,017 in her tax return for the tax year 2017-2018, which amount did, on the basis of her self-assessment, reduce the amount payable for that tax year. HMRC had thus correctly opened an enquiry under s9A into the tax year 2017-2018 because Ms Duncan had incorrectly carried forward losses which were not available.

DISCUSSION

24. HMRC opened an enquiry under s9A TMA 1970 into the return submitted by Ms Duncan for the tax year 2017-2018. They issued a closure notice under s28A on 24 July 2019. In accordance with s50(6) TMA 1970, the burden of proof is on Ms Duncan to establish, on the balance of probabilities, that she has been overcharged by the assessment, otherwise the assessment stands good.

25. Mr Vyse has challenged the amendments made by the closure notice on two alternative grounds as set out above. He only needs to succeed on one of these two arguments in order that the appeal is allowed. I address first the calculation of the income tax liability for the tax year 2017-2018 under ITA 2007 and then whether HMRC correctly opened an enquiry into the use of the losses under s9A TMA 1970.

Calculation of income tax liability and use of personal allowances and carry-forward property losses

26. Section 23 ITA 2007 sets out seven steps for the calculation of income tax liability for a tax year. That applies to the calculation of Ms Duncan's liability for 2017-2018.

27. Section 23 sets out that Step 1 is to identify the income, with each amount of income being a component of total income. The steps which deal with reliefs and/or allowances are Step 2 and Step 3.

28. As can be seen from s23, Step 2 is to 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" (cross-referring to s24 and s25). This gives the "net income". The reliefs listed include, in s24(1)(b), carry-forward property loss relief under s118.

29. Step 3 is to 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 … (individuals: personal allowance and blind person's allowance)" (cross-referring to s25). The allowances include the personal allowance.

30. Mr Vyse was not challenging the fact that the carry-forward property loss relief is provided for at Step 2 and the personal allowance is dealt with at Step 3. Instead, his submission was that it is not necessary that Step 2 is performed before or in priority to Step 3 and that Ms Duncan is permitted (in accordance with the flexibility afforded by s25(2)) to choose to deduct the personal allowance at Step 3 before any deductions that might otherwise have been available at Step 2.

31. There are several strong indicators to support HMRC's submission that s23 sets out the steps which are required to be performed in the temporal order in which they are to be performed:

> (1) Notwithstanding Mr Vyse's submissions to the contrary, I do consider that the natural reading of any provision such as s23 which refers to specified steps being required is that such steps are to be taken in sequence.
>
> (2) Considering the drafting of s23 itself, comprising seven steps in total which are intended "to find the liability of a person…to income tax for a tax year", the logical reading of the whole section is that the steps must be taken in numerical order. In overview, Step 1 is to identify the amount of income, this being "total income", Step 2 leads to the "net income", Step 4 is to calculate tax at the applicable rates and Step 7 is to add the amount of tax left by any amounts for which the taxpayer is liable under any provision listed in s30 and "the result is the taxpayer's liability to income tax for the tax year". There is a beginning and an end to the calculation, from identifying a taxpayer's

income to calculating their tax liability for the year. That result is only achieved by performing each step sequentially.

(3) Furthermore, and related to this, the steps themselves contemplate that they have been performed sequentially. For example, Step 2 says "deduct from the components…" – the components were identified at Step 1; Step 3 says "deduct from the amounts of the components left after Step 2…"; and Step 4 directs that tax is calculated "on the amounts of the components left after Step 3".

(4) Steps 2 and 3 are distinct steps, separate from each other. There is no combined stage at which everything that is potentially deductible is to be taken into account. Instead, Step 2 requires that reliefs under various provisions listed in s24 are deducted and Step 3 requires that any allowances to which the taxpayer is entitled are deducted. If it were intended that all amounts that were potentially available to be deducted be considered together there would have been no need to provide that some are deducted at Step 2 and others at Step 3. This supports there being some significance to the listing of these as separate steps, and the ordering of them.

(5) Section 25(3) then provides that s25(2) is subject to various other statutory provisions, one of which is s118(3) and (4) in relation to carry-forward property loss relief. Section 118(3) states that a deduction is to be made only from profits of the business. Of itself, this does not shed any light on the matter before me. However, s118(4) then goes on to provide that in calculating a person's net income for a tax year, deductions under this section from the profits of a business are to be made before deductions of any other reliefs from those profits. Turning back to s23, it is Step 2 of that section which sets out how to calculate the net income (consistent with s24 having listed carry-forward property loss reliefs as one type of relief that is deductible at Step 2). Section 118(4) thus requires that carried forward property losses are to be deducted first before any other reliefs and, by virtue of s25(3), this overrides s25(2).

32. I recognise that some support for Mr Vyse's submissions can be found in the legislation:

(1) There are some provisions which refer to both Steps 2 and 3. Notable in this regard is s25 itself, s25(1) of which states that this section "supplements the provisions about reliefs and allowances in Steps 2 and 3 of the calculation in section 23". Section 25(2) is that on which Mr Vyse relies heavily, and reads:

> (2) At Steps 2 and 3, deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax.

However, this flexibility does not override the rules which are set out elsewhere, notably s25(3).

(2) Furthermore, the approach taken in s23 can be contrasted with that in s27, which contains express provisions about the order in which tax reductions are to be deducted at Step 6. It was open to the draftsman to include express language in s23 to address the order in which reliefs and allowances are to be applied. However, I consider that this is only necessary if HMRC seeks to set out the priority for use of reliefs and losses within any single step. Section 27 deals with the order within Step 6. HMRC are not requiring that Ms Duncan use reliefs within Step 2 or Step 3 in a particular order – they are requiring that the reliefs in Step 2 are used before the allowances in Step 3.

33. Having regard to all of the above and the submissions of the parties, I agree with HMRC's approach to the interpretation of s23. In calculating Ms Duncan's liability to income tax in accordance with s23 the steps set out in that section must be taken in numerical

order, the consequence of which is that the carried forward property losses have been deducted at Step 2 of that computation in years prior to that under appeal such that those losses have already been used. They have been so used in priority to her personal allowance in those years, which would have been available for deduction only at Step 3, which is undertaken after Step 2.

Procedure for opening an enquiry into the claim to use losses

34. Following the submission of Ms Duncan's tax return for the year 2017-2018, HMRC gave notice of enquiry into that return under s9A TMA 1970. That section permits HMRC to "enquire into a return [made] under section 8 or 8A". Mr Vyse submits that HMRC have used the wrong statutory procedure (such that the enquiry and subsequent closure notice is invalid) and that any enquiry should have been made under Schedule 1A TMA 1970 as Ms Duncan relies on a claim which is "made otherwise than by being included in a return" (s42(11)).

35. This distinction between an enquiry into a return and an enquiry into a claim which is made otherwise than by being included in a return was addressed by the Supreme Court in *HMRC v Cotter* [2013] UKSC 69. The focus, however, of that decision (which I consider further below) was as to what was and was not included in a return, and the significance of whether the amount being challenged affected the appellant's tax liability for the relevant year. It was common ground in that case that Mr Cotter had made a claim to use employment losses (such a claim being required for the use of such losses) and that such claim did not affect the tax chargeable for the year under appeal.

36. I consider the present situation to be different from that in *Cotter* in that no "claim" is required for the use of carried forward property losses. It is clear from s118 and s119 that such losses are carried forward automatically. If they are available then they are offset against income in future years, subject to there being sufficient income. For that reason, I do not consider that it was open to HMRC to give notice of enquiry under Schedule 1A. However, Mr Vyse's submissions also emphasised the difference between a tax return and a tax return form, submitting that the losses, whilst being set out on the online tax return form, were not part of the tax return for 2017-2018 and, in that situation, could not be the subject of an enquiry under s9A. It is for that reason that I consider the decision in *Cotter* in more detail.

37. Mr Cotter had filed his return for the tax year 2007-2008 (without calculating his tax liability for that year) and HMRC then calculated his tax liability for the year. Mr Cotter subsequently amended his return to include a provisional loss relief claim (for employment losses incurred in 2008-2009). HMRC reviewed the return and confirmed its earlier assessment of the tax due for the year 2007-2008. HMRC enquired into the claim to use employment losses under Schedule 1A on the basis that the claim was made "otherwise than by being included in a return".

38. Giving the decision of the Supreme Court, Lord Hodge explained as follows:

> (1) It was accepted on behalf of the appellant (see [17]) that the claim did not affect the amount of tax which was chargeable or payable in relation to 2007-2008.
>
> (2) The taxpayer's submission that HMRC could only enquire under s9A was described as "attractive in its simplicity" (at [20]). The logic was that the claim was made in Mr Cotter's tax return and so Schedule 1A could not apply. Treating everything in the tax return form as the tax return has the benefit of keeping simple both the process of self assessment and the jurisdictional boundary between the specialist tax tribunal and the courts (see [21]).

(3) HMRC's argument was that a claim was included in a "return" for the purposes of s8(1), s9, s9A and 42 only if it affected or could "feed into" the calculation of tax payable in respect of the particular year of assessment.

(4) Where, as in this case, the taxpayer has included information in his tax return but has left it to HMRC to calculate the tax which he is due to pay, HMRC is entitled to treat as irrelevant to that calculation information and claims which do not as a matter of law affect the tax chargeable and payable in the relevant year of assessment. The purpose of a tax return is to establish the amounts of income tax and capital gains tax chargeable for a year of assessment and the amount of income tax payable for that year (at [24]).

(5) The tax return form contains other requests, eg information about student loan repayments, which do not affect the income tax chargeable in the tax year which the return form addresses. The word "return" may have a wider meaning in other contexts within TMA 1970. But in the context of s8(1), s9, s9A and s42(11)(a), a "return" refers to the information in the tax return form which is submitted for "the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax" for the relevant year of assessment and "the amount payable by him by way of income tax for that year" (s8(1)) (at [25]).

(6) The information provided by Mr Cotter alerted HMRC to the nature of the claim for relief. HMRC concluded that the claim in respect of losses incurred in 2008-2009 did not alter the tax chargeable or payable in relation to 2007-2008. HMRC was "accordingly entitled and indeed obliged" to use Schedule 1A as the vehicle for its enquiry into the claim (at [26]).

(7) Matters would have been different if the taxpayer had calculated his liability to income and capital gains tax by completing the tax calculation summary pages of the tax return. In such circumstances HMRC would have his assessment that, as a result of the claim, specific sums or no sums were due as the tax chargeable and payable for 2007-2008. Such information and self assessment would fall within a "return" under s9A as it would be the taxpayer's assessment of his liability in respect of the relevant tax year. HMRC could not go behind the taxpayer's self assessment without either amending the tax return (s9ZB) or instituting an enquiry under s9A (see [27]).

39. The tax return form submitted by Ms Duncan made it clear that she was seeking to deduct carried forward property losses from her income for the tax year 2017-2018, with the consequence that her liability to tax for that tax year would be of a lesser amount than if such losses were not available. In this situation I have no doubt, particularly in the light of the clear authority of *Cotter*, that this information was within her "return" such that HMRC were correct to give notice of enquiry under s9A in order to seek to challenge this use of the losses.

CONCLUSION

40. For the reasons set out above, the appeal is dismissed and the amendments made by the closure notice stand good.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

41. 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.

JEANETTE ZAMAN
TRIBUNAL JUDGE

RELEASE DATE: 25 MARCH 2021