[2014] UKUT 0170 (TCC)
Case number: TCC-JR/10/2012

Film partnerships – partnership trading losses – inclusion of trading losses in partners' self-assessment tax returns – claims to utilise those losses for carry back relief – means of challenge available to HMRC

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

THE QUEEN
on the application of

(1) JORGE MANUEL DE SILVA
(2) BERNARD ALEC DOKELMAN **Claimants**

- and -

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

TRIBUNAL: The Honourable Mr Justice Sales

Sitting in public at The Royal Courts of Justice on 17-18 February 2014

David Southern, instructed by Reynolds Porter Chamberlain LLP, for the Claimant

Alison Foster QC and Aparna Nathan, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Defendants

DECISION

Introduction

1. This is a claim for judicial review of decisions of the Defendants ("HMRC") by which they declined to accept claims by the Claimants (Mr De Silva and Mr Dokelman) for loss relief in relation to investments by them in certain film partnerships. Permission to apply for judicial review was granted by the High Court, which also ordered the claim to be transferred to the Upper Tribunal.

2. The Claimants submit that the issue of law in the case, which arises on the application of complex provisions of the tax code, has been resolved in their favour by the judgment of the Supreme Court in *Revenue and Customs Commissioners v Cotter* [2013] UKSC 69; [2013] STC 2480. HMRC dispute this.

3. As appears from the judgment below, I do not accept the Claimants' submission regarding the effect of *Cotter*. I find that HMRC acted correctly and according to law.

Factual Background

4. Mr De Silva and Mr Dokelman were at the material times both members of a number of film partnerships of which Investing in Enterprise Limited was the general partner.

5. Under the tax code, losses or profits of a film partnership in any tax year are treated as divided between the partners. In the early years of trading, a partner may set off the losses of a film partnership in a particular year against his general income for that year or any of three previous years, by way of "carrying back" the losses to any of those previous years. The opportunity to carry back partnership losses in this way is potentially of considerable value to the partner, in that it allows him to choose to use the losses to offset taxable income across a range of years, depending on when it is most advantageous to him to use the losses in that way.

6. The relevant film partnerships lodged tax returns pursuant to section 12AA of the Taxes Management Act 1970 ("TMA") in which they claimed they had suffered substantial trading losses for the tax years 1999/2000, 2000/2001 and 2001/2002, in relation to which they claimed relief for film expenditure under section 42 of the Finance (No. 2) Act 1992. HMRC proceeded to challenge those claims by way of initiating an enquiry into the returns of the partnerships. On their enquiry, HMRC determined that those losses and those claims for relief should not be accepted and issued closure notices accordingly.

7. The partnerships appealed to the First-tier Tribunal (Tax Chamber) against HMRC's decision to disallow the claimed losses and reliefs.

8. Those appeals and the partnerships' claims for losses and relief for film expenditure under the 1992 Act were compromised by an agreement dated 22 August 2011 made pursuant to section 54 of the TMA between HMRC and each of the partnerships ("the partnership settlement agreement"). Under this agreement, the partnerships were allowed relief for film expenditure and had losses recognised at a considerably reduced level from that included in their tax returns. The individual members of the partnerships were not parties to the partnership settlement agreement.

9. Meanwhile, however, in his self-assessment tax return for 1998/1999, Mr De Silva included a claim to set off trading losses in respect of certain partnerships in other years, including 1999/2000, so as to reduce his payment in respect of tax due for 1998/1999 by £16,800, by including that figure in box 18.9 against the entry on the return form, "1999-2000 tax you are reclaiming now". He also included additional information in his return to explain the detail of the carry back claims he was making to give rise to that figure to off-set against his tax liability. The figure represented Mr De Silva's share of relevant partnership losses, including those for 1999/2000 which it was already estimated the relevant partnership in which he was invested would suffer for that year, as claimed by those partnerships (i.e. at the high rate of losses and reliefs asserted by the partnerships, which came to be challenged by HMRC).

10. In his self-assessment tax return for 1999/2000, Mr De Silva made similar carry-back claims to set off partnership losses in specified years against his income in earlier years (and so claim a repayment of tax for those years), again at the high rate of losses and reliefs asserted by the partnerships, as challenged by HMRC.

11. Mr Dokelman proceeded in a similar way. In his self-assessment tax return for 2000/2001 he included a claim to carry back partnership losses in the sums of £133,000, £35,000, £52,500 and £35,000 in relation to four film partnerships to years prior to the tax years in which the partnership losses were or were expected to be incurred. Again, these sums were stated at the high levels of losses and reliefs asserted by the partnerships, which were then challenged by HMRC.

12. Upon determination in accordance with the partnership settlement agreement of the partnerships' claims for losses and reliefs, significantly reducing the amount of those losses and reliefs below the sums originally claimed by the partnerships, HMRC wrote to the partners to inform them that their carry back claims to set off their shares of the losses and reliefs claimed by the partnerships would now be amended in line with the lower figures agreed in the partnership settlement agreement in respect of those losses and reliefs. This had the effect of increasing the overall amount of tax payable by each partner.

13. HMRC's letters to this effect to Mr De Silva were dated 16 September 2011 and 17 November 2011. HMRC informed him that his relevant self-assessment returns were being amended to reflect his share of the agreed partnership losses, with the result that he was required to pay additional tax of £17,176.80 and £32,400.00.

14. HMRC wrote to Mr Dokelman in a similar way on 28 October 2011. HMRC informed him that his 2000/2001 self-assessment return was being amended to reflect the agreed partnership losses, with the result that his entitlement to carry back partnership losses and set them off against his other income would be reduced.

15. In these proceedings, Mr De Silva and Mr Dokelman seek to quash HMRC's decisions, communicated by these letters, to disallow their claims to carry back partnership trading losses at the original higher rate and to allow only claims to carry back partnership trading losses to reflect the losses agreed in the partnership settlement agreement. There is no right of appeal against these decisions and it is agreed that judicial review is the appropriate way in which they may be challenged.

16. The essence of the Claimants' case is that their claims to carry back the tax reliefs in issue are not to be regarded as claims made in a personal tax return under section 8 of the TMA, but are properly to be regarded as stand alone claims for relief in respect of which HMRC are obliged to apply the challenge procedures contained in Schedule 1A to the TMA rather than the challenge procedures applicable in respect of a return made under section 8 of the TMA. The Claimants say that HMRC failed to operate the challenge procedures under Schedule 1A as they should have done, and are now out of time to do so. HMRC say that they were not obliged to use those procedures in order to rectify (as HMRC would say) the tax returns and claims for carry back relief made by the Claimants.

Analysis of the Statutory Scheme

17. The film partnerships in which the Claimants invested sought to make use of tax reliefs for such partnerships provided by section 42 of the 1992 Act and section 48 of the Finance (No. 2) Act 1997. Under section 42 of the 1992 Act, a taxpayer can elect for what would normally be capital expenditure (and therefore non-deductible) on the making of a film or on its acquisition to be treated as expenditure against income (and therefore deductible). Section 48 of the 1997 Act extended the scope of this relief, including by allowing expenditure to be written off as soon as the film is completed or acquired.

18. The provision which applied at the relevant times to allow taxpayers to set off losses in one trade against other income was section 380 of the Income and Corporation Taxes Act 1988. Section 381 of that Act provided for relief in respect of losses arising in the early years of a trade.

19. A partnership which carries on a trade (as the relevant film partnerships maintained they did), is a transparent entity for the purposes of tax. The profits or losses of the partnership are allocated between and treated as profits or losses of the partners, in accordance with their partnership interests. Both the partnership (under section 12AA of the TMA) and individual partners (under section 8 of the TMA) are required to make tax returns to HMRC for each tax year. Individual partners must include in their returns their share of partnership profits and losses: section 8(1B) of the TMA.

20. Every partnership tax return must include a "partnership statement": section 12AB of the TMA. This must state the share for each partner of any profit or loss of the partnership for the period of the return: section 12AB(1)(b). The individual partner is required to include the relevant amount of profit or loss allocated to him as shown in the partnership statement in his own tax return: section 8(1B) of the TMA.

21. Section 8 of the TMA provides in relevant part as follows:

> **"8. Personal return.**
>
> (1) For the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment, and the amount payable by him by way of income tax for that year, he may be required by a notice given to him by an officer of the Board—
>
> (a) to make and deliver to the officer, a return containing such information as may reasonably be required in pursuance of the notice, and
>
> (b) to deliver with the return such accounts, statements and documents, relating to information contained in the return, as may reasonably be so required.
>
> (1AA) For the purposes of subsection (1) above—
>
> (a) the amounts in which a person is chargeable to income tax and capital gains tax are net amounts, that is to say, amounts which take into account any relief or allowance a claim for which is included in the return; and
>
> (b) the amount payable by a person by way of income tax is the difference between the amount in which he is chargeable to income tax and the aggregate amount of any income tax deducted at source and any tax credits to which [the principal Act] applies.
>
> (1B) In the case of a person who carries on a trade, profession, or business in partnership with one or more other persons, a return under this section shall include each amount which, in any relevant statement, is stated to be equal to his share of any income, loss, tax, credit or charge for the period in respect of which the statement is made.
>
> (1C) In subsection (1B) above "relevant statement" means a statement which, as respects the partnership, falls to be made under section 12AB of this Act for a period which includes, or includes any part of, the year of assessment or its basis period. ..."

22. Section 9 of the TMA provides in relevant part as follows:

"**9. Returns to include self-assessment**

(1) Subject to subsections (1A) and (2), every return under section 8 or 8A of this Act shall include a self-assessment, that is to say –

(a) an assessment of the amounts in which, on the basis of the information contained in the return and taking into account any relief or allowance a claim for which is included in the return, the person making the return is chargeable to income tax and capital gains tax for the year of assessment; and

(b) an assessment of the amount payable by him by way of income tax, that is to say, the difference between the amount in which he is assessed to income tax under paragraph (a) above and the aggregate amount of any income tax deducted at source and any tax credits to which section 231 of the principal Act applies

but nothing in this subsection shall enable a self-assessment to show as repayable any income tax treated as deducted or paid by virtue of section 233(1), 246D(1), 249(4), 421(1), 547(5) or 599A(5) of the principal Act. …

(2) A person shall not be required to comply with subsection (1) above if he makes and delivers his return for a year of assessment –

(a) on or before the 30th September next following the year, or

(b) where the notice under section 8 or 8A of this Act is given after 31st July next following the year, within the period of two months beginning with the day on which the notice is given.

(3) Where, in making and delivering a return, a person does not comply with subsection (1) above, an officer of the Board shall if subsection (2) above applies, and may in any other case –

(a) make the assessment on his behalf on the basis of the information contained in the return, and

(b) send him a copy of the assessment so made;

and references in this Act to a person's self-assessment include references to an assessment made on a person's behalf under this subsection.

(4) Subject to subsection (5) below –

(a) at any time before the end of the period of nine months beginning with the day on which a person's return is delivered, an officer of the Board may by notice to that person so amend that person's self-assessment as to correct any obvious errors or mistakes in the return (whether errors of principle, arithmetical mistakes or otherwise); and

(b) at any time before the end of the period of twelve months beginning with the filing date, a person may by notice to an officer of the Board so amend his self-assessment as to give effect to any amendments to his return which he has notified to such an officer.

(5) No amendment of a self-assessment may be made under subsection (4) above at any time during the period –

(a) beginning with the day on which an officer of the Board gives notice of his intention to enquire into the return, and

(b) ending with the day on which the officer's enquiries into the return are completed. …"

23. Section 9A of the TMA provides:

"9A. Power to enquire into returns

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

(a) the return on the basis of which a person's self-assessment was made under section 9 of this Act, or

(b) any amendment of that return on the basis of which that assessment has been amended by that person, or

(c) any claim or election included in the return (by amendment or otherwise).

if, before the end of the period mentioned in subsection (2) below, he gives notice in writing to that person of his intention to do so.

(2) The period referred to in subsection (1) above is –

(a) in the case of a return delivered or amendment made on or before the filing date, the period of twelve months beginning with that date;

(b) in the case of a return delivered or amendment made after that date, the period ending with the quarter day next following the first anniversary of the day on which the return or amendment was delivered or made;

and the quarter days for the purposes of this subsection are 31st January, 30th April, 31st July and 31st October. …"

24. Section 12AB(1) of the TMA provides that every tax return made by a partnership "shall include a statement (a partnership statement)" showing, among other things, the amount of income or loss sustained by the partnership for the period covered by that return and the amount of such income or loss attributable to each partner. Section 12AB(2) and (3) allows for amendments to be made to a partnership statement, and where they are made section 12AB(4) provides for corresponding amendments to be made to the self-assessment returns of the partners made under section 9 of the TMA.

25. Section 12AC(1) of the TMA provides for a power for HMRC to give notice to enquire into (i.e. challenge) a partnership return and partnership statement within a certain period after the filing date. Where notice of enquiry is given, subsection (3) operates. It provides in relevant part as follows:

> "(3) The giving of notice under subsection (1) above at any time shall be deemed to include –
>
> > (a) the giving of notice under section 9A(1) of this Act to each partner who at that time has made a return under section 9 of this Act or at any subsequent time makes such a return; …"

26. As appears from these provisions, for individuals who have submitted tax returns under section 8 of the TMA, an enquiry may be opened under section 9A. However, where a notice of enquiry into a partnership return (including a partnership statement) is issued under section 12AC, section 12AC(3)(a) has the effect that a notice of enquiry is deemed to be given to each partner under section 9A.

27. In this case, HMRC opened enquiries into the partnership returns in proper time. The question is whether that had the effect, where it was later agreed under the partnership settlement agreement that the losses included in the partnership returns were to be reduced, of allowing HMRC to re-state the tax shown to be due from the Claimants in their relevant individual self-assessment returns.

28. Where an enquiry is opened into an individual's return under section 9A, it is closed by the issue of a closure notice under section 28A(1) of the TMA. Where an enquiry into a partnership return is opened under section 12AC, it is closed by the issue of a closure notice under section 28B. In such a case, if the enquiry into the partnership return leads to a restatement of entries in that return which are relevant to a partner's individual return, then HMRC are required by virtue of section 28B(4) to make amendments to each partner's individual return so as to give effect to the amendments made to the partnership return: it provides that HMRC "shall by notice to each of the partners amend … the partner's self-assessment under section 9 …". HMRC say that it is by reason of section 28B(4) that they were required to re-state

entries in the Claimants' tax returns as they did, once the amount of the partnership losses was finally determined by the partnership settlement agreement.

29. Section 31(1)(b) of the TMA provides for a right of appeal against a closure notice issued pursuant to section 28B in respect of a partnership's return. It was under this provision that the partnerships appealed against the closure notices issued by HMRC in respect of their returns.

30. Where an appeal is determined by a hearing before the First-tier Tribunal (formerly, the Special Commissioners or General Commissioners), section 50 of the TMA provides for the Tribunal to have power to amend the partnership return and the assessed amounts. In particular, section 50(6) and (7) provides that if the Tribunal decides that any amounts contained in a partnership statement are excessive or insufficient, the amounts shall be reduced or increased accordingly. This means that if the Tribunal gives a decision to reduce the trading losses allocated to a partner in respect of a particular tax period as shown in a partnership statement, by reason of the trading losses of the partnership being overstated, the effect would be to reduce the losses which the partner may include in his own individual return relevant to that tax period. Section 50(9) provides that HMRC must amend the partner's individual return to reflect the amendments to the partnership statement made by the Tribunal.

31. Where, on the other hand, an appeal is settled by an agreement made under section 54, the effect is the same as if the agreement were a decision of the Tribunal: see section 54(1). Therefore, when the partnership settlement agreement was entered into, HMRC were required by section 50(9), read with section 54(1), to amend the Claimants' individual returns for the tax periods which corresponded to the periods covered by the partnership statements which were amended pursuant to the partnership settlement agreement. Thus, although the Claimants had already claimed to carry back to earlier years the partnership losses allocated to them for those periods as included by them in their returns for those periods, by the partnership settlement agreement the amounts of the partnership losses for those periods as included in their individual returns for those periods fell to be reduced.

32. The question which arises in these proceedings is whether the Claimants also thereby lost their right to carry back the higher (pre-amendment) partnership losses to set off against their income in earlier years and were accordingly only entitled to carry back the lower (post-amendment) partnership losses. As a matter of substance, I consider it is clear that as a result of the re-statement of the partnership losses under the partnership settlement agreement the Claimants did lose the right to carry back to earlier years the higher (pre-amendment) losses which had been claimed.

33. However, Mr Southern, who appears for the Claimants, submits that this outcome is foreclosed for procedural reasons. He says that this is because the Claimants' claims to carry back the higher (pre-amendment) losses to set off against their income in earlier years were so-called "stand alone" claims for relief, governed by a distinct procedural regime for challenge with its own time limits, and under that

regime HMRC have become time-barred from being able to challenge the carry back claims for relief which have been made.

34. Section 42 of the TMA governs the making of claims to relief from income tax which may or may not be made by including them in a tax return. Section 42 provides in relevant part as follows:

> **"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) and (3A) 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.
>
> (3) Subsections (1A) and (2) above shall not apply in relation to any claim which fails to be taken into account in the making of deductions or repayments of tax under section 203 of the principal Act. …
>
> (5) The references 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;
>
> (6) In the case of a trade, profession or business carried on by persons in partnership, a claim under any of the provisions mentioned in subsection (7) below shall be made –
>
> (a) where subsection (2) above applies, by being included in a return under section 12AA of this Act, and
>
> (b) in any other case, by such one of those persons as may be nominated by them for the purpose.
>
> (7) the provisions are [those listed include sections 41 and 42 of the Finance (No. 2) Act 1992] …
>
> (9) Where a claim has been made (whether by being included in a return under section 8, 8A, or 12AA of this Act or otherwise) and the claimant subsequently discovers that an error or mistake has been made in the claim,

the claimant may make a supplementary claim within the time allowed for making the original claim.

(10) This section (except subsection (1A) above) 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 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 …"

35. The effect of section 42 is that claims must be made in a return if the taxpayer has received notice that they should be filing such a return and it is therefore possible to do so (section 42(2)); in respect of trades carried on by a partnership, a claim under provisions listed in subsection (7) (which include claims for relief under section 42 of the 1992 Act, such as those made by the partnerships in the present case) must be made in the partnership's return in circumstances where subsection (2) applies (section 42(6)).

36. Schedule 1A to the TMA governs "stand alone" claims, that is, claims which are not made in a return. It provides in relevant part as follows:

SCHEDULE 1A
CLAIMS ETC NOT INCLUDED IN RETURNS

1. In this Schedule –
"claim" [means a claim or election] as respects which this Schedule applies.
…

Making of claims

2(1) Subject to any provision in the Taxes Acts for a claim to be made to the Board [HMRC], every claim shall be made to an officer of the Board. …

(3) A claim shall be made in such form as the Board may determine.

Amendments of claims

3(1) Subject to sub-paragraph (2) below –

(a) at any time before the end of the period of nine months beginning with the day on which a claim is made, an officer of the Board may by notice to the claimant so amend the claim as to correct any obvious

errors or mistakes in the [claim] (whether errors of principle, arithmetical mistakes or otherwise); and

(b) at any time before the end of the period of twelve months beginning with the day on which the claim is made, the claimant may amend his claim by notice to an officer of the Board. ...

Giving effect to claims and amendments

4(1) Subject to sub-paragraphs (1A), (3) and (4) below and to any other provision in the Taxes Acts which otherwise provides, 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(4) below, the officer's enquiries are treated as completed; ...

Power to enquire into claims

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.

(2) The period referred to in sub-paragraph (1) above is whichever of the following ends the latest, namely –

(a) the period ending with the quarter day next following the first anniversary of the day on which the claim or amendment was made;

(b) where the claim or amendment relates to a year of assessment, the period ending with the first anniversary of the 31st January next following that year; and

(c) where the claim or amendment relates to a period other than a year of assessment, the period ending with the first anniversary of the end of that period;

and the quarter days for the purposes of this sub-paragraph are 31st January, 30th April, 31st July and 31st October.

(3) A claim or amendment which has been enquired into under sub-paragraph (1) above shall not be the subject of –

(a) a further notice under that sub-paragraph; or

(b) if it is subsequently included in a return, a notice under section 9A(1) or 12AC(1) of this Act or paragraph 24 of Schedule 18 to the Finance Act 1998."

37. Schedule 1B to the TMA governs claims for relief involving two or more years of assessment, including carry back claims of the kind in issue in this case. It provides in relevant part as follows:

SCHEDULE 1B
CLAIMS FOR RELIEF INVOLVING TWO OR MORE YEARS

1(1) In this Schedule –

(a) any reference to a claim includes a reference to an election or notice; and

(b) any reference to the amount in which a person is chargeable to tax is a reference to the amount in which he is so chargeable after taking into account any relief or allowance for which a claim is made. …

Loss relief

2(1) This paragraph applies where a person makes a claim requiring relief for a loss incurred or treated as incurred, or a payment made, in one year of assessment ("the later year") to be given in an earlier year of assessment ("the earlier year").

(2) Section 42(2) of this Act shall not apply in relation to the claim.

(3) The claim shall relate to the later year. …

(6) Effect shall be given to the claim in relation to the later year, whether by repayment or set off, or by an increase in the aggregate amount given by section 59B(1)(b) of this Act, or otherwise. …"

38. It was common ground that where a Claimant made a carry back claim for relief by setting off partnership losses against his personal income in a period earlier than that to which the partnership losses related, he would also have to include a

statement of the partnership losses allocated to him in his individual return for the period to which those losses related (i.e. in his return for the period corresponding with that covered by the partnership return in which the losses are included).

39. Where an individual partner makes a claim to utilise partnership losses arising in a later period by setting them off against his income in an earlier period, I do not think that it is properly to be regarded as a simple "stand alone" claim for relief made outside a return. It is an inchoate claim for relief which, as a matter of substance, will only be validated when the partnership losses are included in the partner's individual return for the later period, reflecting the partnership statement for that period. Several of the claims for relief in this case were rather unusual, since they were asserted by the Claimants (by way of carry back to earlier periods) at a time before the periods to which the relevant partnership statements and in which the trading losses occurred had closed and those partnership statements had been filed, i.e. the carry back claims were made on the basis of what it was expected and estimated the losses attributable to the Claimants for those later periods would be. But the claims for relief could, as a matter of substance, only ultimately be made good if the Claimants also eventually included their shares of the partnership trading losses in their own individual returns for the periods in which those losses actually arose.

40. In a more usual case, where the partnership losses have arisen in the later year, are included in the partnership statement forming part of the partnership return for that year and also in a partner's individual return for that year, and then the partner asks for those losses to be carried back to be set against his general income in prior years, the position would be that much clearer. A challenge by HMRC to the amount of the losses which could be brought into account for the benefit of the partner would be by way of enquiry into the partnership return and partnership statement and hence by deemed inquiry, under section 12AC(3) of the TMA, into the partner's return. This was, in fact, the position in relation to Mr Dokelman's claim in his return for 2000/2001 to bring partnership losses of £133,000 into account.

41. Where a partner makes a carry back claim for relief in respect of partnership losses, HMRC suggested that paragraph 5(1) of Schedule 1A has the effect that HMRC has the option whether to enquire into it (i.e. challenge it) at the stage when the carry back claim is made. HMRC say that paragraph 5(3)(b) of Schedule 1A gives them the choice whether to enquire into that claim as a "stand alone" claim or to enquire into the tax return in which the statement of the losses relevant to that claim is later included. If that is correct, then if HMRC choose to investigate the claim as a "stand alone" claim, paragraph 5(3)(b) would appear to have the effect that they may not then conduct a separate enquiry into the claim when the partnership losses to which it relates are included in the partner's tax return for the period in which the losses arose.

42. I have to say that I have some doubt about whether the suggestion that HMRC had a choice regarding how to challenge the carry back claims in this way is correct. Schedule 1B, particularly when read in the context of the elaborate provisions governing enquiry into partnership returns and the effects of such enquiry, appears to

me to have the effect that the appropriate point of challenge to the amount of the partnership losses would be when the claim is made to bring those partnership losses into account in the year in which they arose, which would be a claim contained in the partnership return and the individual partner's return for that year: see below. There might, I imagine, be some aspects of the carry back claim which did not turn on the extent of the losses in question and on information to be included in those returns, in respect of which the appropriate means of challenge could be by an enquiry under paragraph 5(1) of Schedule 1A into the carry back claim itself, rather than into the tax returns to which it related (e.g. if there were some issue not about the amount of the allowable losses, but about whether the taxpayer had sought to apply them by carry back to a tax year which was properly open to him). In that respect, and to that extent, the carry back claim would be made "otherwise than by being included in a return under section 8, 8A or 12AA [of the TMA]": see section 42(11A) of the TMA. That is not this case.

43. Similarly, it is possible for a taxpayer to make a claim outside any tax return for repayment of tax to him on the basis of a choice to carry back loss relief from a later year to an earlier year (cf *Cotter* at [16], discussed below), and it may be that if this were done HMRC could re-open the whole matter (including the accuracy of any entries in any tax return relevant to the making of such a claim for repayment, even though they had not sought to challenge those entries by use of the enquiry procedure under section 9A of the TMA) by means of an enquiry under Schedule 1A into the carry back claim itself. I do not say that it necessarily would be open to HMRC to do this – it seems to me to be arguable that if they had not challenged the relevant entries in the returns using the procedure under section 9A they might be precluded from challenging those entries in an enquiry under Schedule 1A. However, I do not have to reach any concluded view about this. Again, that is not this case.

44. It is not necessary here to examine further how an enquiry under paragraph 5(1) of Schedule 1A might interact with an enquiry into or Tribunal ruling upon a partnership return and partnership statement, or with the operation of Schedule 1B, because HMRC did not commence an enquiry into the Claimant's carry back claims as "stand alone" claims. Instead, they commenced an enquiry into the relevant partnership returns and partnership statements when they were filed, which automatically had the effect of amounting to an enquiry into relevant individual returns of the Claimants for the corresponding periods by which HMRC challenged the amounts of partnership losses which the Claimants sought to bring into account for the purposes of their tax affairs. In proceeding in that way, I consider that HMRC proceeded in an appropriate and lawful manner.

45. Schedule 1B applies to "stand alone" and other claims which are advanced on a carry back basis, as here. Paragraph 2(3) states expressly that "The claim shall relate to the later year" and paragraph 2(6) provides that "Effect shall be given to the claim in relation to the later year". The effect of these provisions is that the focus in the case of a carry back claim such as those in issue here is on the later year, i.e. the year in which the partnership losses actually arose and were allocated to the partners: cf *Blackburn (Inspector of Taxes) v Keeling* [2003] EWCA Civ 1221; [2003] STC 1162,

[15]-[16]. Since in the later year a partner could only claim to have partnership losses brought into account for the purposes of his tax affairs by including them in his individual tax return for that year, this means that the relevant challenge to his claim to have those losses brought into account is by enquiry into his tax return for that year, and such enquiry is deemed to be opened when HMRC open an enquiry into the partnership tax returns: section 12AC(3).

46. It should also be noted that this interpretation of the effect of Schedule 1B has the effect of bringing into line the substantive and procedural position in respect of challenges by HMRC to carry back claims in relation to partnership losses arising in the later year. It is to be expected, and is a natural inference, that Parliament legislated to achieve this desirable outcome.

47. In my view, it would be very odd to suppose that Parliament intended to produce an outcome that uncoupled the substantive position and the procedural position in this sort of case, so that although as a matter of substance (as here) a partner was only entitled to have partnership losses at the lower (post-amendment) rate brought into account in his favour, yet HMRC would be prevented from bringing those losses at the lower rate into account for the procedural reason that they had not launched an enquiry into the tax affairs of the partner within the relevant time limit applied to the earlier stage when a claim to carry back such losses was intimated to them, and instead would have to accept that the partner could rely on the higher (pre-amendment) losses. Such a result would cut across the basic principle evident in the scheme of the legislation regarding taxation of partners in respect of partnership profits and losses, which is to look through the partnership to tax the individual partners on their shares of those profits and losses. It would have required clear statutory language to produce such a strange result at odds with the basic scheme of the tax code. Yet there is no such language. On the contrary, the language used in paragraph 2(3) and (6) of Schedule 1B is in my view a clear injunction to the opposite effect, requiring focus on how the claim to have partnership losses brought into account is made in the later year and whether challenge is mounted to the claim in the later year by proper procedure and in proper time, as it was here.

48. This interpretation of the effect of Schedule 1B is further reinforced by the way in which it harmonises with section 50 of the TMA. Where there is an appeal by a partnership to the First-tier Tribunal, that Tribunal is an independent and impartial tribunal charged with resolving the relevant dispute between HMRC and the partnership and with determining the relevant sums to be treated as included in returns and partnership statements. The principle of the rule of law, as applicable within the context of the tax code, leads one to expect that where the Tribunal determines some relevant issue, its decision will be binding and will be given effect. Section 50(9) achieves this by providing that where the Tribunal adjusts relevant sums in a partnership statement, HMRC is required to change partners' individual self-assessment returns to give effect to its decision. Mr Southern's submission that HMRC may, for procedural reasons, in certain circumstances be prevented from doing this, or that if HMRC do do this it would have no material effect on the tax

position of the individual partners, would undermine the intended effect of section 50(9) and the principle of the rule of law of which it is an expression.

Legal Analysis and the Judgment in Cotter

49. In his submissions, Mr Southern placed particular emphasis on the judgment of the Supreme Court in *Cotter*. He said that the judgment in *Cotter* directly supported the legal analysis proposed by the Claimants and had the effect that HMRC had proceeded in an unlawful manner and that this judicial review claim should succeed.

50. I do not accept this submission. In my view, there is nothing in the judgment in *Cotter* which leads to the conclusion that HMRC have acted unlawfully in the circumstances of this case.

51. In this case, the Claimants included claims to set off their shares of the partnership losses in later years in their individual returns for earlier years. This was simply a convenient way of intimating to HMRC that they would wish to set off those losses (which would only in fact arise in the later years) against their income in the earlier years. The parties are agreed that the fact that the Claimants proceeded in this way does not mean that those claims were "included in a return" for those earlier years for the purposes of section 42 of the TMA: see *Cotter* at [24]-[25]. In fact, the Claimants could have chosen other means, such as a simple letter to HMRC, to indicate that they wished to carry back the partnership losses from the later years to the earlier ones.

52. Whichever method was used to indicate that the Claimants wished to carry back those losses to earlier years, the effect of paragraphs 2(3) and 2(6) of Schedule 1B was that their claims to have those losses brought into account in their favour were treated as claims in respect of the later years (i.e. the years when the partnership losses actually arose). In those later years, the Claimants were required to include the information about the losses in their individual returns for those years, as information submitted "for the purpose of establishing the amounts to which a person is chargeable to income tax and capital gains tax" for those years of assessment and "the amount payable by him by way of income tax for that year" (section 8(1) of the TMA; *Cotter*, [26]). It is only if partnership losses can be brought into account for those years of assessment that a right to carry back those losses arises. So, properly speaking, such claims were not simple "stand alone" claims, in the sense in which Mr Southern used that term. HMRC used appropriate means to challenge the relevant entries for partnership losses as included in the Claimants' returns for the later years, by making enquiry into those returns by means of making enquiry in proper time into the partnership returns for the relevant periods in which the losses arose (see section 12AC(3)).

53. For these reasons and the further reasons set out in the analysis of the statutory scheme, above, I therefore reject Mr Southern's contention that Schedule 1A has the effect that a challenge to the Claimants' claims to carry back the partnership losses had to be made by way of an enquiry into their carry back claims made in their

individual returns for earlier years (before the partnership losses actually arose), and within the time limit for such an enquiry set out in Schedule 1A. HMRC were not confined to challenging the carry back claims intimated in the Claimants' returns for the earlier years by giving notice to amend the claims under paragraph 3(1) of Schedule 1A (within the time limit stipulated in that paragraph) or by commencing an enquiry into the claims under paragraph 5(1) of Schedule 1A (within the time limit stipulated in that paragraph). On the contrary, the appropriate (or, at the least, *an* appropriate) and legitimate means for HMRC to challenge the Claimants' claims to bring into account the partnership losses as a foundation for carrying back the benefit of those losses to earlier years was to proceed as they did, by challenging the partnership returns for the years in which the losses were actually said to have been incurred by means of commencing an enquiry into those returns, which automatically constituted an enquiry into and challenge to the entries relating to those losses in the Claimants' self-assessment returns for those years.

54. In *Cotter*, the taxpayer filed his tax return for 2007/2008 in October 2008. In that return, he left it to HMRC to produce the relevant calculation of the tax due from him and he made no claim for loss relief. In January 2009, the taxpayer wrote to HMRC enclosing a provisional loss relief claim for 2007/2008 and amendments to his return for that year. The amendments added entries in the return intimating that he had sustained an employment related loss of £710,000 in 2008/2009 for which he claimed relief, to be carried back to 2007/2008 to reduce the tax due from him in relation to that year - i.e. much as the Claimants included claims for carry back relief from later years in their returns for earlier years in this case. The taxpayer said that his tax for 2007/2008 should be reduced to nil on this basis. HMRC accepted that the tax return for 2007/2008 was amended and stated that enquiries would be opened into the carry back claim and that return. HMRC said that their enquiry would be under Schedule 1A of the TMA (i.e. on the footing that the carry back claim was a "stand alone" claim, not included in a tax return). The taxpayer, however, contended that the enquiry was properly to be regarded as an enquiry under section 9A of the TMA into his return for 2007/2008, which would have had the effect of postponing his obligation to pay tax said to be due in respect of that year until the enquiry had been completed. HMRC did not accept this, and brought legal proceedings to recover what they maintained was the outstanding tax payable for 2007/2008 while their enquiry into the carry back claim remained on foot. The court at first instance ruled in favour of HMRC on this point. The Court of Appeal allowed the taxpayer's appeal, holding that if HMRC wished to dispute an item contained in a tax return they had to follow the enquiry procedure set out in section 9A of the TMA. The Supreme Court allowed HMRC's appeal against this ruling.

55. It should be noted that the position in *Cotter* was the converse of the position in this case. HMRC maintained successfully that the taxpayer's carry back claim was a "stand alone" claim, not required to be made in a return, and that their enquiry was made under paragraph 5(1) of Schedule 1A; while the taxpayer contended that the enquiry was made under section 9A, as an enquiry into a self-assessment return. But it is important to emphasise that the return which the taxpayer said was the subject of an enquiry under section 9A was his return for 2007/2008 (the earlier year), even though

the relevant losses on which he sought to rely arose in 2008/2009 (the later year). Neither party invited attention to the possible application of section 9A in respect of the return for the later year. That would not have assisted the taxpayer in his efforts to postpone payment of his tax in relation to the earlier year and the Supreme Court did not have to address that question.

56. By contrast, in the present case, HMRC maintain that their relevant enquiry (which is deemed to include an enquiry under section 9A) is into the partnership returns and corresponding individual partner returns in respect of the later years (i.e. the years in which the partnership losses actually arose and were reflected as required in the relevant returns), *not* into the individual partner returns for the earlier years. This is, in my judgment, an important point of distinction between *Cotter* and the present case.

57. In *Cotter*, the Supreme Court was addressing a situation in which the taxpayer had not made a claim for carry back relief (from 2008/2009) in his original tax return for 2007/2008, but sought to make it later, in January 2009. Its ruling (see [38]), was that the claim for relief based on a loss in 2008/2009 did not afford a defence to HMRC's demand for the payment of the tax assessed for 2007/2008. HMRC correctly interpreted the materials sent in by the taxpayer in January 2009 as a claim for relief in respect of losses for 2008/2009 which "did not alter the tax chargeable or payable in relation to [2007/2008]": see [26], per Lord Hodge JSC for the Court.

58. Lord Hodge continued at [26], "The Revenue was accordingly entitled and indeed obliged to use Schedule 1A of TMA as the vehicle for its enquiry into the claim (s. 42(11)(a))." At first glance this seems a slightly curious statement, because it leaves out of account the possibility, following on in particular from the operation of Schedule 1B to the TMA, that HMRC would be entitled to enquire into the taxpayer's return for 2008/2009 and use that enquiry as a vehicle to challenge the claim for relief based on losses in that tax year which the taxpayer wished to carry back to set off against his income in the earlier year. I think the explanation for this is that neither the taxpayer nor HMRC argued that such a possibility was relevant to the particular dispute between them and appear not to have drawn this possibility to the attention of the Court. Indeed, so far as one can tell from the facts in the case, the statement seems to be clearly correct and beyond dispute: it does not appear that the taxpayer had sought to make any entry in his return for 2008/2009 relevant to his claim for carry back relief in relation to which an enquiry into *that* return under section 9A of the TMA would be relevant. The interaction of the provisions which I have reviewed above was not the subject of examination by the Supreme Court, because such examination was not necessary on the arguments which it had to address. I do not consider that this sentence in the judgment of Lord Hodge precludes the analysis of the statutory provisions set out above or the possibility of a challenge to the relevant claim in this case by way of an enquiry into the partnership return for the later years and corresponding deemed enquiry into the individual partner returns for the later years.

59. In my view, the part of Lord Hodge's judgment in which he directly addresses Schedule 1B is consistent with and supports the analysis I have set out in this judgment. For the purposes of his examination whether the taxpayer was correct in his contention that his carry back of a claim relating to 2008/2009 was part of his "return" for 2007/2008, at para. [15] he set out the material provisions in Schedule 1B and at para. [16] analysed their relevance to the taxpayer's argument as follows:

> "16. In my view it is clear, in particular from paragraphs 2(3) and (6), that the scheme in Schedule 1B allows a taxpayer, who has suffered a loss in a later year ("year 2") and seeks to attribute the loss to an earlier year of assessment ("year 1"), to obtain his relief by reducing his liability to pay tax in respect of year 2 or by obtaining a repayment of tax in year 2. It does not countenance by virtue of the relief any alteration of the tax chargeable and payable in respect of year 1. On the contrary, the sum for which the taxpayer receives relief in year 2 is the difference between what was chargeable in year 1 and what would have been chargeable "on the assumption that effect could be, and were, given to the claim in relation to that year" (paragraph 2(4)). In other words, the relief is quantified on the basis that the tax liability in year 1 has already been assessed."

60. This analysis appears to me implicitly to include the possibility, which on the arguments presented to him Lord Hodge did not have to examine, that a challenge to the claim for relief based on a carry back claim which is made in the first manner contemplated by him (by the taxpayer "reducing his liability to pay tax in respect of year 2", i.e. in his return for year 2) could be made by means of enquiry into that return under section 9A of the TMA (the general provision governing challenges to entries which are properly to be regarded as part of a taxpayer's "return") rather than by means of an enquiry under Schedule 1A to the TMA. On the other hand, if, apart from the entries required to be included in his return for year 2, the taxpayer claims "a repayment of tax in year 2", that would be a "stand alone" claim to make use of the relief and the relevant enquiry provision would be that in Schedule 1A. The case which the Supreme Court had to consider was of this latter kind, hence the remarks of Lord Hodge in his judgment at para. [26] regarding the obligation to use the procedure in Schedule 1A.

61. At para. [27] of his judgment, Lord Hodge said that matters in *Cotter* would have been different if the taxpayer had made his own assessment of his tax liability by bringing his carry back claim for relief into account in the calculation of his tax liability in his return: "Such information and self-assessment would in my view fall within a 'return' under s. 9A of TMA as it would be the taxpayer's assessment of his liability in respect of the relevant tax year", and HMRC could not go behind that self-assessment without either amending the return under section 9ZB of the TMA or instituting an enquiry under section 9A of the TMA. That is to say, in such a case the appropriate means of challenge to the claim for relief would be by way of an enquiry under section 9A into the taxpayer's return and not by way of an enquiry under Schedule 1A into a "stand alone" claim. This is in line with, and supports, the points made in para. [60] above regarding para. [16] of the judgment of Lord Hodge. Where

an entry relating to carry back relief is made in the calculation of the tax due for a particular year in a return for that year, the appropriate means of challenge by HMRC is by way of an enquiry into the return itself, not under Schedule 1A.

62. Adapting this observation to the circumstances of the present case, where an entry which is the foundation for carry back relief is made in the taxpayer's return for a particular year (here, the entry showing the partnership losses included in the Claimants' returns for the later years), an appropriate (if not, in fact, *the* appropriate) means of challenge by HMRC to that entry and in that respect to the claim for carry back relief is by way of an enquiry into the return itself, rather than an enquiry under Schedule 1A. This was the means of challenge which HMRC has employed in the present case. It is, in my judgment, an entirely lawful means of challenge for them to have used. A taxpayer cannot expect to be immune from a challenge to a claim for carry back relief while still vulnerable to having relevant entries in his tax return for the later year corrected pursuant to a challenge to that return brought in proper time.

Conclusion

63. For the reasons set out above, I dismiss this claim for judicial review.

64. I should add, by way of postscript, that HMRC made an additional and distinct submission to the effect that by virtue of the partnership settlement agreement and the effect given to it under section 54 of the TMA, the Claimants were simply precluded from denying that the relevant amounts of the partnership losses to be brought into account for the purposes of their carry back claims for relief were any different from those agreed in that agreement. I was not impressed by this submission, to the extent that it was said to have an effect without going through the legal analysis set out above, to trace the impact of the partnership settlement agreement upon the Claimants' individual tax returns via the challenges HMRC made to the relevant partnership statements by means of their enquiry into those statements. Had HMRC's defence based on that analysis failed, I would have rejected this separate argument. The Claimants were not parties to the partnership settlement agreement and so were not directly bound by its terms. The relevance of that agreement in the context of this claim is in my view solely by reason of the combined operation of sections 50 and 54 of the TMA and the way in which they govern the outcome of the enquiries into the relevant partnership statements and the Claimants' individual returns which were properly commenced by HMRC.

THE HONOURABLE MR JUSTICE SALES
RELEASE DATE: 15 APRIL 2014