THE COTTER CASE — WHEN IS A 'RETURN' NOT A 'RETURN'?

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On 6 November 2013, the Supreme Court published its judgment on the Cotter case. This is a procedural case in relation to a claim on the Self Assessment tax return to carry back an employment loss to the tax year prior to the year of the loss. It was a test case and it is understood that up to 200 cases were on hold awaiting the outcome.

Cotter v HMRC [2013] UKSC 69

Why is this case important?

The judgment narrowly defines the meaning of 'return' for the purposes of TMA 1970, ss 8(1), 9, 9A, 42(11) to mean only the information on the tax return which establishes the amount of income tax and capital gains tax due for that tax year. Consequently, any information on the return which does not establish the tax due is not 'on the return'.

Essentially, the judgment allows HMRC to ignore tax relief due as a result of the carry back of employment losses under ITEPA 2003, s 128 so long as the taxpayer's return did not include a self assessment of the tax due (ie no tax calculation was submitted). HMRC may also seek to apply this to all loss relief carry back claims (ie wider than just employment losses).

It also clarifies the procedures which HMRC must follow in order to challenge the amount of losses carried back.

The main focus of this news item is the facts of the case and the judgments of both the Court of Appeal and the Supreme Court. However, this case has potentially far-reaching (and perhaps unintended) consequences for all Self Assessment taxpayers and tax advisers. Questions still to be addressed in relation to the judgment include:

- are all loss claims involving more than one year affected by the judgment even where the specific provision in ITA 2007 does not include a clause to state that the relief is subject to TMA 1970, Sch 1B?
- is HMRC required to take into account (and possibly repay) reductions in tax due to sideways loss relief claims where the taxpayer has submitted the tax calculation?
- how does the judgment impact trust and estates tax returns, as the meaning of return in TMA 1970, s 8A was not considered (in relation to trust and estate returns the judgment only refers to TMA 1970, s 9A)?
- if losses carried forwards are not 'on the return', when does the enquiry window close in relation to these losses?

- how should advisers and taxpayers proceed in relation to current enquiries into sideways loss relief claims opened under incorrect provisions?
- is there any scope for recovering tax and penalties paid by a taxpayer as a result of an enquiry opened under TMA 1970, Sch 1A when it should have been opened under TMA 1970, s 9A and vice versa?

These points are discussed in detail in the Wider implications of the Cotter case news item.

The facts

Mr Cotter filed his 2007/08 tax return on 31 October 2008. No tax calculation was included with the return and therefore HMRC sent him a tax calculation showing £211,927.77 due.

After this date, Mr Cotter took part in a tax avoidance scheme involving employment losses. An amended return was submitted on 29 January 2009 to include the carry back of the employment loss to the 2007/08 tax year. No tax calculation was included with the amended return.

The agent sent a copy of the loss relief claim to the HMRC recovery office and stated that as a result of the claim "no further 2007/08 taxes will be payable by Mr Cotter".

HMRC confirmed in writing that Mr Cotter's tax return had been amended, however it stated that it would not take account of the tax reduction resulting from the carry back of the loss until the enquiry (opened under TMA 1970, Sch 1A) into the loss was concluded. HMRC started collection proceedings to collect the tax due based on the original tax calculation.

HMRC issued proceedings in the County Court in June 2009 to collect the tax due plus interest and in February 2010 the proceedings were transferred to the High Court.

Cotter v HMRC [2013] UKSC 69 at 2–11

Decisions of the lower courts

As the proceedings were started in the County Court rather than the First-tier Tribunal, there are only two decisions to consider.

High Court

In April 2011, the High Court ruled that the taxpayer could not rely on the loss claim as a defence against the tax demand.
Cotter v HMRC [2011] STC 1646 (subscription sensitive)

Court of Appeal

In February 2012, the Court of Appeal came to the opposite conclusion to the High Court.

The case turned on whether a taxpayer is entitled in law to make a claim on the tax return for a loss which arose in a later year. Although TMA 1970, Sch 1B entitled 'Claims for relief involving two or more years' disapplies the normal requirement that claims must be made in the tax return if that is possible, there are boxes on the return which allow the taxpayer to enter the loss and the tax repayment due on the earlier year's return.

HMRC contended that the taxpayer is **not entitled** to make such a claim on the prior year return. However, space is provided on the return for such a claim for the **convenience** of the taxpayer. Arden LJ summed up the HMRC argument as:

"saying that, despite apparently being permitted to insert the information...in his return, the appellant was in fact not to be treated as having done so because the relevant statutory provisions did not permit him to claim relief for a loss incurred in one year against a liability to tax for an earlier year. On this argument, the form was wrong to give him this opportunity."

Cotter v HMRC [2012] STC 745 at 25

HMRC's position was that since loss claims involving more than one year must be claimed under TMA 1970, Sch 1B, any enquiry into the claim must be made under TMA 1970, Sch 1A rather than TMA 1970, s 9A, and this is the procedure they had followed in Mr Cotter's case.

HMRC's argument was rejected by the Court of Appeal. They said it would require the taxpayer to look behind every entry of the tax return to determine whether he was entitled in law to make a claim for relief on the return. Arden LJ considered that this would "impose an intolerable burden on taxpayers, especially [the unrepresented taxpayer]" and would lead to further litigation to establish whether TMA 1970, Sch 1A or TMA 1970, s 9A would apply before the substance of the claim could be examined.

Instead, Arden LJ took a purposive approach to the interpretation of TMA 1970, s 9A. Under TMA 1970, s 9A(4) the enquiry into the return can extend to "anything contained in the return, or required to be contained in the return". The words 'contained in' cannot mean 'required to be contained in' since that would make the first part of the phrase redundant. Drawing parallels with the case of *Langham v Veltema*, Arden LJ stated that HMRC's narrow interpretation of the meaning of 'return' for the purposes of TMA 1970, s 9A was inconsistent with the original purpose of the Self Assessment regime to "simplify and bring early finality to liability to tax".

Cotter v HMRC [2012] STC 745 at 26–27

In summary, the Court of Appeal decided that HMRC's position could not have been the intention of Parliament.

Judgment of the Supreme Court

The Supreme Court took a different approach to the relevant legislation, deciding that the word 'return' for the purposes of TMA 1970, ss 8(1), 9, 9A, 42(11) has a very narrow meaning:

"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'."

Cotter v HMRC [2013] UKSC 69 at 25 (subscription sensitive)

Overruling the Court of Appeal, Lord Hodge, giving the judgment of the court, said he was persuaded "that the Revenue is right in its interpretation of 'return' [because] income tax is an annual tax and that disputes about matters which are not relevant to a taxpayer's liability in a particular year should not postpone the finality of that year's assessment".

Cotter v HMRC [2013] UKSC 69 at 28

Lord Hodge also drew a distinction in procedure between taxpayers who provide their own tax calculation and those who leave the calculation to HMRC.

Where the taxpayer produces his own tax calculation in situations such as this, the only avenue open to HMRC if it wishes to challenge the tax due is to correct the return under TMA 1970, s 9ZB on the grounds that the taxpayer has made an error of principle. If the taxpayer rejects the amendment then HMRC can then open a TMA 1970, s 9A enquiry.

Cotter v HMRC [2013] UKSC 69 at 34

However, if **HMRC** calculates the tax due it "is entitled to treat as irrelevant to that calculation information and claims, which clearly do not as a matter of law affect the tax chargeable and payable in the relevant year of assessment."

Cotter v HMRC [2013] UKSC 69 at 24

Conclusion

The two main conclusions to be drawn from the Supreme Court judgment are:

- the word 'return' in TMA 1970, ss 8(1), 9, 9A, 42(11) means only the information on the tax return which establishes the amount of income tax and capital gains tax due for that tax year. Consequently, any information on the return which does not establish the tax due is not 'on the return'

- the enquiry procedure into loss claims which are not 'on the return' (ie are losses which arose in a later tax year) depends on who calculates the tax due:
    - if the taxpayer submits the tax calculation and includes the disputed loss in that calculation, any enquiry must be opened under TMA 1970, s 9A and the tax cannot be collected until the enquiry is concluded (or until the conclusion of any subsequent litigation)
    - if HMRC calculates the tax liability, the enquiry must be opened under TMA 1970, Sch 1A, even though it is made on the face of the return

However, there are a number of problems with the judgment which may be compounded by the fact that the case by-passed the Tax Tribunal altogether, starting at the High Court. This means that the case was never heard by tax specialist judges.

These problems include:

- the mismatch between the charging provisions in ITA 2007 and the collection provisions of TMA 1970 (as interpreted by the Supreme Court)
- the computational rules for calculating the tax due are fixed by law, meaning it is difficult to understand why the person who calculates the tax should be relevant to the amount payable

These points and the potential consequences for other taxpayers mentioned at the beginning of this news item are discussed in the Wider implications of the Cotter case news item.