Analysis

Developments in HMRC's formal information powers

Speed read

HMRC's information powers are developing due to continued pressure to increase tax yield, combined with additional demands for data from its international counterparts. Whilst there has been little change in the primary legislation recently, practice has changed significantly with the interpretation of such powers being explored in case law. It has traditionally been understood that HMRC's Sch 36 powers were only applicable within the UK, but this was called into question in *Jimenez* and also by HMRC's 2018 consultation on extending its powers. It would also appear that HMRC's approach to drafting Sch 36 notices has altered: Sch 36 requests appear to be issued at a much earlier stage in enquiries than previously; and the requests themselves appear to be more broadly drafted. Recent cases have tested both the restrictions on Sch 36 requests for professional papers, and HMRC's (apparently shifting) interpretation of the definition of 'power or possession'.

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HMRC's primary formal information gathering powers are set out in FA 2008 Sch 36. Despite relatively few changes to this primary legislation in the last decade, the application of its powers in practice has changed significantly. Whilst these changes initially responded to other shifts in HMRC's wider enquiry practices, the extension in how its information powers could be interpreted have in turn resulted in new approaches to HMRC investigations.

This article looks at how recent years have seen changes in both the fundamental assumptions of how Sch 36 should be interpreted and also the practical implications of these powers. In particular, the changes in recent case law and 2018's consultation on HMRC's information powers have been considered.

Formal notices

HMRC's power to call for documents under FA 2008 Sch 36 covers all taxes with specific wording for non-resident capital gains tax (NRCGT), stamp duty land tax (SDLT) and annual tax on enveloped dwellings (ATED). Schedule 36 states that information may be requested under a formal notice, as long as it is 'reasonably required' to check the tax position of a taxpayer, subject to certain restrictions. Formal information notices are generally issued when HMRC has requested the information informally but the taxpayer has not supplied the desired information.

Schedule 36 covers a range of situations where HMRC may need to gather or obtain information. The two most frequently issued notices are those served to taxpayers under enquiry, and those served to third parties about a known taxpayer already under enquiry (known respectively as taxpayer and third party notices).

Taxpayer notices are governed by Sch 36 para 1 and there are restrictions built into the legislation which allow taxpayers to formally appeal against such notices if HMRC operates outside its remit.

Third party notices are a power granted to HMRC by Sch 36 para 2 and there are additional taxpayer safeguards connected with third party notices. These notices must be approved either by the taxpayer under enquiry or by the tribunal before they can be issued. In addition, before a tribunal approved notice can be given, the third party must first be given the opportunity to make representations in respect of the notice. Once a tribunal notice has been issued, a copy of the notice must generally be given to the taxpayer, unless there are reasonable grounds to suspect that doing so will prejudice the collection of tax.

In *HMRC (ex parte a taxpayer)* [2018] UKFTT 65, the principle of providing a copy of a third party notice to the taxpayer was explored. The difficulty for HMRC here was that information was required from the company accountant, in respect of a company which had been liquidated. HMRC wished to collect certain PAYE and NICs liabilities in relation to the company and applied for a third party notice to the FTT to check the tax position of the company. The FTT refused on the grounds that a copy of the notice could not be served on a company which had been liquidated. It is worth noting, however, that HMRC then reapplied for a third party notice to check the tax position of the directors who could be provided with a copy of the notice, which was allowed.

Tribunal approved third party notices may only be appealed on the basis that they are unduly onerous. HMRC's recent consultation document *Amending HMRC's civil information powers* (published on 10 July 2018) has proposed some major changes to its powers on third party notices, including proposals to

take away some of these safeguards, which are discussed below.

International scope and the impact of the CRS

It has traditionally been understood that HMRC's Sch 36 powers were only applicable within the UK. However, the scope of the powers has been called into question as a result of the recent case *R (on the application of Jimenez and another) v the FTT and HMRC* [2019] EWCA Civ 51, and also by the 2018 consultation that HMRC held on the Sch 36 information powers. These developments are significant since the global information exchanges due to base erosion profit shifting (BEPS) or the common reporting standard (CRS) are likely to lead to more situations where the international reach of the powers becomes relevant.

In *Jimenez*, HMRC served a taxpayer notice on the individual at his Dubai address. It was accepted by all parties that the information requested was reasonably required for checking the individual's UK tax position. However, the individual asserted that HMRC could not serve a notice on him outside of the UK. Since the notice had been tribunal-approved before issue, the individual was only able to contest the taxpayer notice's validity through a judicial review.

The Court of Appeal unanimously held that the sending of a taxpayer's notice to the taxpayer in Dubai did not contravene any international obligation of the UK and hence was validly issued.

The judgment noted that there was a strong public interest to allow HMRC to have effective information powers. Also, even where Parliament appeared to have drafted powers with only a domestic focus in mind, this did not prevent the courts from permitting an international reach to those same powers should the situation demand it. Interestingly, the cases cited in the judgment were cases of bankruptcy and fraud, which was not relevant to the taxpayer in the case of *Jimenez*. Nonetheless, the courts ruled in HMRC's favour and this has set a significant new precedent that looks likely to enable HMRC to assert its Sch 36 powers beyond UK borders. As noted above, this is likely to be particularly significant in an era of global information exchange.

As part of the global transparency developments of the last decade, HMRC is not only seeking information from abroad but also sharing UK data with its counterparties in other jurisdictions. This point was emphasised in the 'Amending HMRC's civil information powers' consultation mentioned above. The consultation examined whether HMRC's Sch 36 powers remained fit for purpose a decade after their introduction. A key driver cited in the consultation was that HMRC anticipated being asked to provide more detailed information to overseas tax authorities to assist them in their reviews of the high level data already provided by the UK under the CRS.

One of the proposals was that third party notices would be aligned with taxpayer notices, such that a third party notice could be approved by an authorised officer, rather than by the taxpayer under enquiry or the tribunal. The third party would only be able to appeal on the grounds that the notice was onerous; the current appeal rights for taxpayer notices would not be mirrored under the proposals.

Despite HMRC identifying an international context to these changes, the response from the accountancy and legal professions was that there could well be UK ramifications too. In particular, concern was expressed that removing taxpayer safeguards around issuing third party notices may result in poor quality notices being issued to taxpayers, without sufficient checks before issue and with limited appeal rights for the recipient. These concerns were echoed in the report published on 4 December 2018 by the House of Lords' 'The powers of HMRC: treating taxpayers fairly'. The report concluded that the proposals were not targeted enough and took away important taxpayer safeguards.

Even under the current rules, HMRC has sometimes been criticised for poor behaviour in relation to information requests. In *Anstock* [2017] UKFTT 307, the appeal against a penalty for non-compliance with a taxpayer notice was allowed, as it was found that there was no evidence that the notice was actually sent or received and as such the appeal was allowed. The FTT held that the appeal would have been allowed in any case, as the notice was 'so poorly drafted' that the recipient could not have understood what was required of him. In particular, the FTT highlighted examples of questions which did not specify what type of information was being requested and thus were too broadly drafted.

The proposed changes to third party notices and the precedent set by the *Jimenez* case demonstrate that taxpayers and their advisers need to remain aware of what HMRC is entitled to do in relation to information requests. These points are examined more below.

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Large scale information requests

It would also appear that HMRC's approach to drafting Sch 36 notices has altered.

First, Sch 36 requests appear to be issued at a much earlier stage in enquiries than previously. This could potentially be in light of questions from the Public Accounts Committee (PAC) into whether HMRC is pursuing enquiries effectively and in a time efficient manner. This is likely to encourage inspectors to turn to HMRC's formal information powers, rather than to give taxpayers multiple extensions to informal requests.

Secondly, the requests themselves appear to be more broadly drafted. HMRC appears to be focusing at present on technically complex enquiry matters, and the subject matter of these investigations may require HMRC to gather large volumes of data.

In the case of complex technical enquiries, formal information requests are often drafted very broadly; for example, requesting 'all information' or 'all email traffic' in relation to a transaction. It should be noted that in the *Anstock* case, HMRC was specifically criticised for drafting an information request so broadly that a taxpayer could not be sure how to comply with the notice. In addition, in some large scale technical enquiries, HMRC appears to be repeatedly asking taxpayers to provide the same information that has already been shared with the inspector earlier in the enquiry.

Recipients of such requests can understandably be concerned about how to comply appropriately. In practice, having discussions with inspectors at an early

stage can enable requests to be more appropriately tailored before a formal notice is issued. Once a formal notice has been issued, it is important to consider whether HMRC is legitimately entitled to all information sought. This is discussed further below.

Restrictions on requests for professional papers

As mentioned, it is important to be aware of what information HMRC is legally entitled to. In particular, providing information to HMRC to which it is not entitled can set a difficult precedent later on in the enquiry. This should be distinguished from proper cooperation in providing information to which HMRC is entitled.

In some cases, there may be a concern that HMRC has asked for information too early in an enquiry. For example, HMRC often requests a director's personal bank records at the start of a corporate enquiry. It may be that it becomes clear later on in the enquiry that elements of such bank statements are relevant to the tax position of the company; however, this is unlikely to be evident at the beginning of an enquiry when HMRC's concerns have not been articulated. Therefore, advisers should always consider carefully whether the information is reasonably required to check the taxpayer's tax position.

In addition to the requirement that information must be reasonably required to check a taxpayer's tax position, Sch 36 contains several other restrictions on what data may be requested by HMRC. The best known of these relates to legal privilege and HMRC cannot insist on seeing legally privileged communications. Legal professional privilege (LPP) covers confidential communications between a solicitor and their client and is recognised as a fundamental human right.

The case of *DAC Beachcroft LLP v HMRC* [2018] UKFTT 502 concerned a third party information notice issued to a taxpayer's legal adviser, in respect of a conveyancing file of a predecessor firm which was in their possession. The conveyancing file related to a number of property acquisitions and disposals. HMRC sought to establish where the central management and control of an offshore company was, as it had been involved in the property transactions. Whether or not legal privilege applied to the conveyancing file was disputed, and the judge held that almost all of the papers in the file were covered by legal privilege.

It was found that communications between the conveyancing solicitor and their clients were privileged where they were for the purpose of seeking or giving advice in relation to the conveyancing transactions. To the extent that they did not specifically seek or provide actual legal advice, the communications largely comprised the necessary exchange of information relating to legal advice and thus were covered by privilege. In addition, correspondence between the conveyancing solicitors and those who were acting as the client's agents (who were not themselves clients of the solicitors) for the purpose of obtaining advice from the solicitors, were also found to be covered by privilege.

The judge concluded that all documents were covered by privilege to 'the extent they either seek or give (or evidence the seeking or giving of) legal advice' or are part of the 'continuum aimed at keeping both [solicitor and client] informed so that advice may be sought and given as required'. There were limited documents which were not found to be protected, including client engagement letters. This case therefore provides a useful summary as to which types of documents may be covered by legal privilege in the context of communications around legal advice.

Whilst tax advice papers don't carry the same protection as legally privileged documents, HMRC's *Compliance Handbook* at CH22300 makes it clear that there are limited circumstances in which an inspector should request these.

Finally, HMRC is not entitled to see audit working papers. In *HMRC (ex parte a taxpayer)* [2018] UKFTT 541, HMRC was looking to obtain audit information and working papers from a firm that had acted as both auditor and accountant for a taxpayer. The case concerned the interaction of Sch 36's comments on tax advice and audit papers; and whether the interaction allowed HMRC to 'switch off' the general provision against providing audit papers set out in Sch 36 para 24.

The judgment concluded that the protection in para 24 against HMRC receiving audit papers took precedence, including over the perceived public interest:

> 'Paragraph 24 recognises that even where the information is reasonably required to check a person's tax position, it may nonetheless be protected from disclosure. It follows that Parliament has necessarily concluded that the public interest in protecting auditor's papers and information from disclosure can, at least in some situations, outweigh the public interest in ensuring that the right amount of tax is paid.'

HMRC's application for the FTT to approve the information notice was therefore denied.

Power and possession

Returning to the fundamental language of Sch 36, another area where HMRC's practical interpretation of Sch 36 appears to be shifting is on the definition of 'power or possession'. Schedule 36 para 18 states that a recipient of a formal information notice is only required to produce a document if it is in the person's 'possession or power'. Whilst possession carries the relatively straightforward meaning of physical possession, power is less easy to define.

Power relates to the ability to obtain the document or a copy of it from whoever holds it; this has usually been interpreted as meaning the legal power to obtain. However, in *Alvi* [2016] UKFTT 201, the information requested on a tax avoidance scheme was not readily available to the taxpayer, who therefore refused to comply with the Sch 36 notice on the grounds that the documents were not in his power. The information was obtainable from the trust of which the taxpayer was the principal settlor and also from the scheme promoter. The FTT decided that the information requests were entirely proper and reasonable and, even if the taxpayer did not have this information, he had a right to request it and was therefore required to provide it in response to the notice. A similar situation was debated in *Parissis and others v HMRC* [2011] UKFTT 218.

Both these cases related to personal tax scenarios, but there is anecdotal evidence that HMRC is applying the 'right to request' concept in corporate tax enquiries too; for example, asking a UK subsidiary to request information from an overseas group entity. In corporate situations, it may be easier to disprove whether that 'right to request' exists, depending on the group structure in place and the relationship between the two entities. For example, if the UK entity was a relatively junior member of a group, then the 'right to request' is unlikely

to exist, although the company may have to be seen to demonstrate this before HMRC accepts that documents are not in the UK party's power.

Conclusion

Formal information requests are an area of HMRC practice that show how enquiry procedures evolve, even without fundamental changes in primary legislation. This evolution comes from a combination of new case law testing established rules and new HMRC enquiry approaches in an era of global transparency. As discussed above, these changes are likely to continue given the introduction of the CRS.

Anecdotal evidence also suggests that HMRC is more willing to issue non-compliance penalties for formal information notices. Indeed, the 2018 consultation on information powers suggested that going forwards HMRC would be able to request the tribunal to issue daily non-compliance penalties of up to £1,000 a day. At present, that power exists only for the relatively rare 'identity unknown' notices under Sch 36 para 5, and other notices can incur daily penalties of up to £60 a day.

HMRC has recently received criticism from the House of Lords for being too aggressive in relation to exercising its formal powers. The House of Lords report commented that a combination of external pressures on HMRC and decreasing inspector numbers have led the department to prioritise tax yield over customer service. This would appear to be borne out by HMRC's increasing readiness to issue and enforce formal information requests within enquiries. Whilst the feedback from the House of Lords report may have an impact in the long run, it has not yet filtered down in to practice, at least in relation to Sch 36 notices.

Advisers should take into account these developments when responding to information requests on behalf of their clients, with particular thought as to whether HMRC is entitled to the information requested and whether there is any flexibility in responding to large scale information requests.

HMRC information powers is an evolving area where HMRC is looking to optimise its powers and access to information. The proposal to amend HMRC civil information of powers is likely to cause changes in the current legislation, and it will be interesting to see the changes and how HMRC will act upon these in the near future.

Action points

- Know your rights or your client's rights and what information you are required to provide to HMRC.
- Keep up to date with the any changes in the Sch 36 legislation following HMRC's proposal to amend HMRC's civil information powers.
- Be aware of the implications of not responding to information requests within the required timeframe. ■

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