Michaelmas Term
[2013] UKSC 69
On appeal from: [2012] EWCA Civ 81

JUDGMENT

Cotter (Respondent) *v* Commissioners for Her Majesty's Revenue & Customs (Appellant)

before

Lord Neuberger, President
Lord Sumption
Lord Reed
Lord Toulson
Lord Hodge

JUDGMENT GIVEN ON

6 November 2013

Heard on 3 October 2013

Appellant	*Respondent*
Ingrid Simler QC Scott Redpath (Instructed by Her Majesty's Revenue and Customs)	Keith Gordon Ximena Mantes Manzano (Instructed by JMW Solicitors)

LORD HODGE (with whom Lord Neuberger, Lord Sumption, Lord Reed and Lord Toulson agree)

1. This appeal raises a question about the boundary between the jurisdiction of the First-tier Tribunal (Tax Chamber) and that of the county court or the High Court. Underlying that issue is a question of the legality of the approach which Her Majesty's Commissioners of Revenue and Customs ("the Revenue") have taken to entries which a taxpayer, Mr Cotter, made in a tax return. This is a test case as we have been told that about 200 taxpayers have used the tax scheme which Mr Cotter has used. The case turns on the proper interpretation of provisions in the Taxes Management Act 1970 ("TMA").

The facts

2. Mr Cotter filed his tax return for the 2007/08 year of assessment on 31 October 2008. In his return he made no claim for loss relief. As he is entitled to do, he left it to the Revenue to calculate the tax due for that tax year. On 24 December 2008 the Revenue produced a tax calculation based on Mr Cotter's return. It showed income and capital gains tax due of £211,927.77.

3. On 29 January 2009 Mr Cotter's accountants wrote to the Revenue and enclosed a "provisional 2007/08 loss relief claim" and amendments to his 2007/08 tax return. The amendments added various entries to boxes in the tax return intimating that Mr Cotter had sustained an employment-related loss of £710,000 in the tax year 2008/09 for which he claimed relief under sections 128 and 130 of the Income Tax Act 2007 ("ITA"). In particular, the claim for relief was made in:

> (i) the main tax return in box 19 on page TR6 under "Any other information";
>
> (ii) the capital gains summary in box 14 on page CG1 in which the figure of £314,583 was inserted, and under "Any other information" in box 35 on page CG2; and
>
> (iii) the "Additional Information" pages.

4. In the "Additional Information" pages, Mr Cotter inserted "£395,417" in Box 3 on page Ai3 ("Relief now for 2008-09 trading, or certain capital, losses") and "2007-08" in box 4 on that page ("and the tax year for which you are claiming relief"). On page Ai4, box 17 ("Additional Information") he explained, as he had done on box 19 on page TR6 and in box 35 on page CG2, that his claim was made under sections 128 and 130 of ITA for an employment-related loss which he had sustained in the tax year 2008/09.

5. The provisional loss relief claim ended with these words:

> "I acknowledge that my interpretation of the tax law applicable to the above transactions and the loss (and the manner in which I have reported them) may be at variance with that of [the Revenue]. Further please note that although I have reported (and hereby claim the loss pursuant to section 128 ITA 2007) in box 3 above I wish to make it clear that the deduction I am claiming on my return is not necessarily what you may regard as 'relief now for 2008-09 trading, and certain capital losses' – for these reasons I assume you will open an enquiry."

6. On 30 January 2009 the accountants sent a copy of the loss relief claim to the Revenue's West Cheshire recovery office. They stated: "As a result of this claim no further 2007/08 taxes will be payable by Mr Cotter".

7. After sending a holding reply, the Revenue responded on 5 March 2009 to confirm that the tax return had been amended and to state that enquiries would be opened into the claim and the tax return. The letter stated that the Revenue did not intend to give effect to any credit for the loss until those enquiries were complete. On the same date the Revenue issued a fresh tax calculation which again stated Mr Cotter's liability for the tax year 2007/08 at £211,927.77. On 11 March 2009 the Revenue wrote to Mr Cotter to intimate that it was enquiring into the amendment and the 2008/09 loss claim under Schedule 1A to TMA. In a further letter on the same date the Revenue asked Mr Cotter to provide specified information and documents. On 24 March 2009 Mr Cotter's accountants wrote to the Revenue's recovery office to inform it that they had asked the Revenue to amend the self assessment calculation and that as a result "no further 2007/08 taxes will be payable by Mr Cotter."

8. Mr Cotter's accountants asserted in correspondence (i) that no further taxes were payable for 2007/08 because of the loss claim which was the subject of enquiry and (ii) that if tax were due as a result of an enquiry under section 9A of TMA, that tax was not payable until the enquiry had been completed. Mr Cotter

also instructed NT Advisors LLP ("NT") to respond to the Revenue's recovery unit and to the threat of legal proceedings. In an undated letter which that unit received on 14 May 2009, NT contended that legal proceedings would be unlawful because (i) Mr Cotter's self assessment showed that no tax was payable as at 31 January 2009 and (ii) the Revenue had not amended the self assessment return.

9. After further correspondence about, among other things, the tax avoidance scheme which had been used to generate the loss claim, the Revenue issued legal proceedings in St Helens County Court on 22 June 2009. Its claim was for the income tax and capital gains tax for 2007/08 and the first payment to account for the year of assessment 2008/09 in the sum of £203,342, together with statutory interest. In his defence Mr Cotter argued (a) that he was entitled to use his loss claim to reduce to nil the tax otherwise payable for 2007/08 and (b) that the Tax Chamber of the First-tier Tribunal had exclusive jurisdiction to determine whether he could make the loss claim in his 2007/08 tax return and thereby reduce the tax payable for that year.

10. On 12 February 2010 the proceedings were transferred to the Chancery Division of the High Court, Manchester District Registry to determine the issue of jurisdiction. In a judgment handed down on 14 April 2011, David Richards J, the Vice-Chancellor of the County Palatine of Lancaster, held (a) that the court had jurisdiction to determine in collection proceedings whether the taxpayer was entitled to rely on the claim for relief as a defence to a demand by the Revenue for immediate payment and (b) that Mr Cotter was not entitled to rely on his claim for loss relief as a defence to the Revenue's demand for payment of the tax due in respect of 2007/08. The Vice-Chancellor granted Mr Cotter permission to appeal.

11. On 8 February 2012, the Court of Appeal (Arden, Richards and Patten LJJ) allowed Mr Cotter's appeal. In their judgment, the Court of Appeal analysed the self assessment procedure and held that if the Revenue wished to dispute an item contained in a tax return, it had to follow the enquiry procedure set out in section 9A of TMA which would have given Mr Cotter a right of appeal to the First-tier Tribunal. Neither the county court nor the High Court had jurisdiction to determine whether the taxpayer was entitled to make his claim in his tax return for 2007/08 for an income loss incurred in 2008/09.

12. The Revenue appealed to this court.

The tax provisions governing employment loss relief

13. Section 128 of ITA provides for employment loss relief. It provides:

"128 Employment loss relief against general income

(1) A person may make a claim for employment loss relief against general income if the person –

(a) is in employment or holds an office in a tax year, and

(b) makes a loss in the employment or office in the tax year ("the loss-making year").

(2) The claim is for the loss to be deducted in calculating the person's net income –

(a) for the loss-making year,

(b) for the previous tax year, or

(c) for both tax years.

(See Step 2 of the calculation in section 23.)"

14. Sub-section (7) provides:

"This Chapter is subject to paragraph 2 of Schedule 1B to TMA 1970 (claims for loss relief involving two or more years)".

Section 42(11A) of TMA provides the same: Schedule 1B to TMA has effect in respect of claims for relief involving two or more years of assessment. It is not disputed that Schedule 1B applies to Mr Cotter's claim for relief.

15. Paragraph 2 of Schedule 1B to TMA provides:

"(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.

(4) Subject to sub-paragraph (5) below, the claim shall be for an amount equal to the difference between –

(a) the amount in which the person is chargeable to tax for the earlier year ("amount A"); and

(b) the amount in which he would be so chargeable on the assumption that effect could be, and were, given to the claim in relation to that year ("amount B").

(5)Where effect has been given to one or more associated claims, amounts A and B above shall each be determined on the assumption that effect could have been, and had been, given to the associated claim or claims in relation to the earlier 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. ...."

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.

17. Income tax is an annual tax, and liability to such tax is calculated in relation to a particular tax year: sections 4 and 23 of ITA. Mr Gordon, who appeared for Mr Cotter, did not argue in this court that he was entitled to deduct the relief

against income and gains in 2007/08. He accepted that paragraph 2(6) of Schedule 1B to TMA provides that effect is to be given to the claim in year 2. He was correct to make that concession. Accordingly, the claim did not affect the amount of tax which was chargeable or payable in relation to 2007/08. There was therefore no issue between the parties as to the correct assessment to tax in that year.

18. The Revenue's use of the taxpayer's income tax liability in 2007/08 in quantifying his obligation to make payments to account for 2008/09 on 31 January and 31 July 2009 (section 59A(1) and (2) of TMA) does not affect the finality of the 2007/08 assessment. Whatever rights the claim for relief might have given the taxpayer in relation to a payment to account for 2008/09, if the Revenue had accepted its validity, it did not affect his obligation to pay the tax payable for 2007/08.

Whether the Revenue acted legally by instituting an enquiry under Schedule 1A

19. The conclusion that the relief could not diminish the tax chargeable and payable for 2007/08 is central to the Revenue's contention that it was entitled to initiate an enquiry under Schedule 1A to TMA, which allowed the postponement of relief until the completion of the enquiry (Schedule 1A, paragraph 4(3)). But Mr Gordon submitted that the Revenue might enquire only under section 9A of TMA, which allows an officer to "enquire into a return" or an amendment of the return (section 9A(1) and (5)). That enquiry extends to:

> "anything contained in the return, or required to be contained in the return, including any claim or election included in the return," (Schedule 9A, paragraph (4)).

He argued that section 42(11) excluded the possibility of a Schedule 1A enquiry. That sub-section provides:

> "Schedule 1A to this Act shall apply as respects any claim which –
>
> (a) is made otherwise than by being included in a return under section 8, 8A or 12AA of this Act".

20. Mr Gordon's submission was attractive in its simplicity. The word "return" in the TMA should be given its ordinary meaning. It was defined in section 118 (unless the context otherwise required) as including "any statement or declaration under the Taxes Acts". The claim was made in Mr Cotter's tax return and so

Schedule 1A could not apply. The Revenue could enquire only under section 9A and it had not done so.

21. I recognise the force of that submission, which found favour in the Court of Appeal. 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. But, as Ms Simler explained on behalf of the Revenue, it exposes the Revenue to irrelevant claims made in the tax return form which have no merit and which serve only to postpone the payment of tax which is payable. There was, she suggested, a risk that the Court of Appeal's decision would encourage marketed tax avoidance schemes which would give a cash flow advantage to taxpayers, even if the schemes were ultimately found to be ineffective.

22. The Revenue's argument was that a claim was included in a "return" for the purposes of sections 8(1), 9, 9A and 42 of TMA only if it affected or as Ms Simler put it, could "feed into", the calculation of tax payable in respect of the particular year of assessment.

23. In judging the rival contentions it is in my view important to recall the sequence of events which I set out in paragraphs 2 – 7 above. First, Mr Cotter gave information relating to his tax affairs in his initial return form. But he did not carry out the calculation of the tax which he was due to pay for 2007/08. Secondly, the Revenue made that calculation. Thirdly, Mr Cotter then provided the information about his provisional loss relief claim in his amendment of the tax return. Fourthly, the Revenue reviewed the return and confirmed its assessment of the tax due for 2007/08, treating the claimed relief as irrelevant to that assessment. Finally, Mr Cotter's advisers disagreed with the Revenue's view but did not seek to amend the tax return (under section 9ZA of TMA) by carrying out their own calculation of tax. In particular, I do not construe the letter of 30 January 2009 from Mr Cotter's accountants as an amendment of his tax return. The accountants did not purport to produce a self assessment calculation. Their amendment of the return was confined to the intimation of the claim. The statement in the letter of 30 January 2009 that no further 2007/08 taxes would be payable was merely an assertion in a covering letter.

24. Where, as in this case, the taxpayer has included information in his tax return but has left it to the Revenue to calculate the tax which he is due to pay, I think that the Revenue 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. It is clear from sections 8(1) and 8(1AA) of TMA that 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. The Revenue's calculation of the tax due is made on behalf of the taxpayer and is treated as the taxpayer's self assessment (section 9(3) and (3A) of TMA).

25. The tax return form contains other requests, such as information about student loan repayments (page TR2), the transfer of the unused part of a taxpayer's blind person's allowance (page TR3) or claims for losses in the following tax year (box 3 on page Ai3) 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. But, in my view, in the context of sections 8(1), 9, 9A and 42(11)(a) of the TMA, 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" (section 8(1) TMA).

26. In this case, the figures in box 14 on page CG1 and in box 3 on page Ai3 were supplemented by the explanations which Mr Cotter gave of his claim in the boxes requesting "any other information" and "additional information" in the tax return. Those explanations alerted the Revenue to the nature of the claim for relief. It concluded, correctly, that the claim under section 128 of ITA in respect of losses incurred in 2008/09 did not alter the tax chargeable or payable in relation to 2007/08. The Revenue was accordingly entitled and indeed obliged to use Schedule 1A of TMA as the vehicle for its enquiry into the claim (section 42(11)(a)).

27. Matters would have been different if the taxpayer had calculated his liability to income and capital gains tax by requesting and completing the tax calculation summary pages of the tax return. In such circumstances the Revenue 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 2007/08. Such information and self assessment would in my view fall within a "return" under section 9A of TMA as it would be the taxpayer's assessment of his liability in respect of the relevant tax year. The Revenue could not go behind the taxpayer's self assessment without either amending the tax return (section 9ZB of TMA) or instituting an enquiry under section 9A of TMA.

28. It follows that a taxpayer may be able to delay the payment of tax by claims which turn out to be unfounded if he completes the assessment by calculating the tax which he is due to pay. Accordingly, the Revenue's interpretation of the expression "return" may not save it from tax avoidance schemes. But what persuades me that the Revenue is right in its interpretation of "return" is that 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.

Jurisdiction

29. The First-tier Tribunal ("the tribunal"), as the successor of the general and special commissioners, has exclusive jurisdiction to hear taxpayers' appeals against assessments to tax (*Autologic Holdings plc v Inland Revenue Commissioners* [2006] 1 AC 118, Lord Nicholls of Birkenhead at paras 12-15, Lord Millett at para 62 and Lord Walker of Gestingthorpe at para 84). But, as explained below, we are not dealing in the present case with an assessment to tax in respect of a particular year of assessment, but how the Revenue has dealt with a loss relief claim relating to a later year.

30. The Revenue did not need to amend Mr Cotter's return form (under section 9ZB of TMA) in order to calculate the tax which it assessed as payable for 2007/08. There was therefore no rejection by Mr Cotter of a Revenue correction (under section 9ZB(4) of TMA). There was no section 9A enquiry. The Revenue did not have to amend the self assessment under section 9C of TMA during such an enquiry and there was no appeal against such an amendment of the return by the Revenue (under section 31 of TMA). The only appeal which Mr Cotter's accountants made was an appeal by letter of 17 April 2009 against a late payment surcharge (under section 59C(7) of TMA), because he claimed that his losses meant that no tax was due. As a result, the only issue for the tribunal was the late payment surcharge. Nothing else occurred to engage the jurisdiction of the tribunal.

31. The Revenue's position was simple: its calculation, based on the information which Mr Cotter had included in his tax return form, showed that he was due to pay tax in the sum it assessed on his behalf for 2007/08. The tax return form for 2007/08 did not show a loss claim which reduced Mr Cotter's liability to tax in respect of that tax year. As the Revenue lawfully commenced an enquiry under Schedule 1A of TMA and elected (under paragraph 4(3)(a) of that Schedule) not to give effect to the claim until the end of the enquiry, there was no postponement of payment of the tax due on 31 January 2009 by giving effect to the claim in the interim. The taxpayer was obliged to pay the amount of tax which had been assessed less any payment to account (section 59B of TMA) and the Revenue was entitled to raise collection proceedings in the county court (section 66 of TMA). I agree with that position.

32. In this case, the county court was not asked to rule on the validity of the claim for loss relief. Nor was it concerned with any appeal against the assessment

to tax. It was asked to determine in collection proceedings whether the taxpayer's claim for relief for losses incurred in 2008/09, which he had made in his tax return form for 2007/08, constituted a defence to the Revenue's claim for immediate payment of the tax which it had calculated as payable in respect of 2007/08. In my view, the county court and the High Court had jurisdiction to determine that issue which did not trench upon the tribunal's exclusive jurisdiction.

How the system works

33. The Court of Appeal expressed concern about the risk of satellite litigation and delays in tax collection if the Revenue were correct in its submission on the meaning of "return" in the relevant provisions. For that reason, it is appropriate that I should say something about how, as I see it, the system works.

34. Where a taxpayer makes a claim for relief in a tax return form which is on its face relevant to the year of assessment (as, for example, when he claims employment loss relief in year 2) or where the taxpayer chooses under section 9(1) of TMA to calculate the amount of tax that he is due to pay, and allows for the relief in his calculation, the Revenue, if it disagrees, will have the option of correcting the return under section 9ZB of TMA, which extends to errors of principle. If the taxpayer rejects the correction (under section 9ZB(4)), that correction has no effect. The Revenue may give notice of an enquiry under section 9A. When the Revenue completes the enquiry by issuing a closure notice under section 28A, the taxpayer may appeal a conclusion stated or amendment made in the closure notice (under section 31(1)(b) of TMA). Similarly if the Revenue amends the self assessment during the enquiry under section 9C to prevent loss of tax, the taxpayer may appeal to the tribunal (section 31(1)(a)). Until this procedure is complete, effect is given to the claim, unless it results in a repayment (section 59B(4A) of TMA).

35. Where the taxpayer chooses to let the Revenue calculate the tax due but includes a claim for relief in a tax return form (whether from the outset or by amendment) which is clearly not relevant to the calculation of tax for the particular year of assessment, the Revenue may ignore the claim in its calculation of the tax under section 9(3) of TMA. It treats it as a claim made otherwise than in a return and Schedule 1A to TMA applies (section 42(11)(a) of TMA). In the procedure under that Schedule, if the Revenue considers that the claim contains obvious errors, it can amend the claim (paragraph 3). If satisfied that the claim is valid, the Revenue is to give effect to the claim promptly (paragraph 4). If not so satisfied, the Revenue may enquire into the claim and not give effect to it until the enquiry is completed (paragraphs 4(3) and 5). Thus the Revenue may collect the tax due for a year of assessment on the basis that the claim is not effective. On completion of

the enquiry (paragraph 7), the taxpayer can notify the Revenue of an appeal (paragraph 9) and thus place the dispute before the tribunal.

36. The Revenue's submission, which I have accepted, that some entries in a tax return form are not part of the tax return for the purposes of, among others, sections 9 and 9A of TMA, may create avoidable uncertainty to taxpayers and their advisers. But that uncertainty could be removed if the return form which the Revenue prescribes (section 113 TMA) were to make clear which boxes requesting information were not relevant to the calculation of tax due in the particular year of assessment. In particular, the Revenue could make this clear where the form provides for the intimation of "stand-alone" claims which relate to another tax year.

Conclusion

37. As I have concluded that the Revenue did not have to give effect to the claim for relief before the conclusion of the enquiry, I do not need to consider a submission, which the Revenue sought to raise late in the day, that section 35 of the Crown Proceedings Act 1947 and CPR Rule 66.4 prevent a taxpayer from pleading set off against the Crown.

38. The claim for relief based on an employment-related loss in 2008/09 did not provide a defence to the Revenue's demand for the payment of the tax assessed for 2007/08. I would therefore allow the appeal so as to restore paragraphs 1 and 2 of David Richards J's order of 5 May 2011.