Analysis

The high income child benefit charge post-*Wilkes*

Speed read

In *HMRC v Wilkes*, the Upper Tribunal held that HMRC may not impose the high income child benefit charge (HICBC) by means of a discovery assessment issued under TMA 1970 s 29 where the individual liable to the charge did not file a self-assessment tax return. The UT found that HMRC had interpreted TMA 1970 s 29(1)(a) too broadly as it could not be inferred that it was intended by Parliament to cover any shortfall in tax; the FTT's approach in *Wiseman* was rejected as being 'an overly strained interpretation of s 29(1)(a)'; and the legislation did not contain an obvious drafting error that should be corrected following the principles in *Inco Europe*. The UT found for the taxpayer on all three of HMRC's arguments, and its reasoning seems unassailable. Affected taxpayers in a similar position should therefore consider lodging appeals. It remains to be seen how HMRC will respond.

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HMRC v J Wilkes [2021] UKUT 150 (TCC) is a much awaited decision of the Upper Tribunal which tests HMRC's ability to impose the HICBC by means of discovery assessments issued under TMA 1970 s 29 where the individual liable to the charge did not file a self-assessment tax return. In this case, Mr Wilkes had appealed against three discovery assessments issued to him in December 2018 for the tax years 2014/15 to 2016/17 on the ground that TMA 1970 s 29(1)(a) did not empower HMRC to issue the assessments in respect of the HICBC. Because Mr Wilkes had not filed a SATR in any of the tax years in question, it was common ground that neither TMA 1970 s 29(1)(b) nor s 29(1)(c) could be construed as empowering HMRC to issue the assessments. So the sole issue in the UT was whether the FTT had been right to hold that s 29(1)(a) only empowers HMRC to issue a discovery assessment if HMRC discover *income* which ought to have been assessed to income tax.

HMRC fairly acknowledged that the legislation imposing the HICBC does not specify an amount of income upon which income tax is charged: instead, a charge to income tax is imposed, in the *amount* calculated under ITEPA 2003 s 681C. In Mr Wilkes' case, there was none: all of the tax on his income had been collected through PAYE.

The HICBC

Child benefit may be claimed by an individual responsible for bringing up a child who is under 16 (or under 20 if they stay in approved education or training).

The Coalition Government decided to restrict child benefit from 6 April 2012 for taxpayers who have an adjusted net income (ANI) in excess of £50,000. If they have a partner, the charge applies if they or their partner (whether or not cohabiting) have an ANI in excess of £50,000.

Instead of means testing child benefit through the benefits system (which would have imposed a significant burden on HMRC), the government instead introduced a new tax charge (the HICBC) designed to claw it back. This new charge was to apply regardless of who actually received the benefit, the level of income of the lower-earner, or in respect of whose child the benefit payments were made. It was to be collected through self-assessment, thereby putting the onus of compliance on taxpayers. Individuals who are liable to pay the HICBC are required to notify liability to HMRC under TMA 1970 s 7 and to file a SATR for the tax year in question.

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As a result, some families simply do not claim child benefit, unaware of the potential impact this may have on their entitlement to contributory benefits. In ignorance of the charge, many taxpayers have failed to notify their liability and pay the charge through their tax return. The £50,000 threshold has not been increased since the HICBC was introduced, so more families are being drawn into the HICBC net each year. Since 6 April 2021, basic rate taxpayers are within its scope.

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Taxpayer awareness of the HICBC

The current version of the child benefit claim form explains the HICBC and requires information that should enable HMRC to determine whether the HICBC is relevant to any given taxpayer. However, many individuals (including Mr Wilkes's wife) claimed child benefit long before the HICBC was introduced, and were unaware of both the HICBC and their potential liability to it.

From 2016/17, HMRC instituted a process by which they could identify taxpayers who might be liable to the HICBC in order to send 'nudge' letters to them to facilitate collection of the HICBC. This is what they did in Mr

Wilkes' case: Mr Wilkes contacted HMRC after receiving such a nudge letter in November 2018; the HMRC officer checked the disclosure and then raised the assessments. No penalties were charged, because HMRC accepted Mr Wilkes had a reasonable excuse for his default.

As was recorded in the FTT decision ([2020] UKFTT 256 (TC) at para 20), Mr Wilkes (then represented by his wife) made a number of well-founded criticisms of the HICBC. But the appeal did not turn on these points: it is for Parliament to review the HICBC, and, if desired, to reshape the charge and the mechanisms for its collection (as the Office of Tax Simplification has called for in its October 2019 report, *Taxation and life events: simplifying tax for individuals*). The role of the UT on Mr Wilkes' appeal was simply to determine whether the mechanism adopted by HMRC for collecting the HICBC in Mr Wilkes' case had been correct.

The parties' arguments in the UT

HMRC put forward three reasons why s 29(1)(a) should be construed so as to confer on HMRC the power to issue discovery assessments:

1. HMRC argued that the reference in s 29(1)(a) to 'income' should be purposively construed as a reference to 'any amount liable to income tax'. (It is unclear how reading 'income' as 'amount liable to income tax' could help HMRC given that the HICBC is a freestanding charge, not an 'amount liable to income tax'.)
2. HMRC also relied on the approach adopted by the FTT in *N Wiseman v HMRC* [2020] UKFTT 383 (TC) in which the FTT had dismissed the taxpayer's appeal. In *Wiseman*, the FTT sought to fill the gap by reasoning that all of the taxpayers income ought to have assessed to income tax; on the basis that no return was submitted, income had not been assessed to a further charge to income tax: the HICBC. Accordingly, HMRC had indeed made a discovery that there was 'income' which ought to have been assessed to income tax and had not been so assessed.
3. Finally, HMRC argued that the legislation contained an obvious drafting error which should be corrected. Here HMRC relied on the principle derived from *Inco Europe Ltd v First Choice Distribution* [2000] 1 WLR 586 (*Inco Europe*). The FTT had found in favour of HMRC in *M Haslam v HMRC* [2020] UKFTT 304 (TC), accepting that a rectifying construction could be applied to s 29. In *Wilkes*, HMRC argued in favour of a rectifying construction of FA 2012 Sch 1 to FA 2012 (which introduced the HICBC by amendment to provisions of ITEPA 2003; it also amended TMA 1970 s 7 (but not s 29) and ITA 2007 s 30).

Mr Wilkes's case was that s 29(1)(a) is perfectly clear on its terms. It did not empower HMRC to issue the assessments and no application of the doctrine of purposive construction could lead to a different result. The FTT had been right (for the reasons it had given) to hold that 'income' means income and not 'an amount liable to income tax' and that there was no drafting anomaly that can or should be corrected on an *Inco Europe* basis. In relation to the *Wiseman* point, Mr Wilkes argued that the HICBC is not a charge on Mr Wilkes' income but a freestanding charge conditional on (inter alia) Mr Wilkes having a certain level of income.

Notably, the HICBC is one of several freestanding charges listed under ITA 2007 ss 30 and 32 that are dealt with separately from the calculation of a taxpayer's liability to income tax in respect of their own income (to which steps 1 to 6 of the calculation in ITA 2007 s 23 apply). The charges listed in s 30 are intended to be capable of self-assessment, hence their inclusion in step 7 of the calculation in s 23. But otherwise, different rules apply to these charges for different purposes. Special statutory modifications are made to enable them to be assessed to tax by HMRC.

In broad terms, the taxpayer's case was that treating the HICBC charge (and other freestanding charges) differently from the 'usual' charge to tax on income was neither absurd nor anomalous but a long-standing feature of the tax code.

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The decision

Having carefully considered the three arguments raised by HMRC, the UT dismissed its appeal and upheld the FTT's decision.

On HMRC's first argument, the UT agreed with Mr Wilkes that HMRC had expressed the purpose of s 29(1)(a) too broadly: it could not be inferred from the wording of that provision that it was intended by Parliament to cover any shortfall in tax. The UT rejected HMRC's argument that the longer time limits which apply to the making of discovery assessments (as compared with the issuing of notices under TMA 1970 s 8) made the situation unworkable or absurd. Indeed, the UT took account of the fact that the time limit for issuing notices under s 8 had been introduced when TMA 1970 s 36A was inserted by FA 2016, following the Upper Tribunal's decision in *R (oao of Higgs) v HMRC* [2015] UKUT 92 (TCC).

Second, the UT also rejected the *Wiseman* argument, recognising that the argument 'really amounts to reading [s 29(1)(a)] as if it simply referred to a discovery that insufficient income tax … had been paid' (para 117). The UT stated that the FTT in *Wiseman* had adopted 'an overly strained interpretation of s 29(1)(a)' which was not correct (para 126).

HMRC fared no better with its *Inco Europe* argument that there was an obvious drafting error which should be corrected. The UT's decision on this aspect merits closer examination, not least because of its potential impact in respect of various pensions related income tax charges under FA 2004 Part 4. (In this regard, see the decision of the FTT in *Monaghan v HMRC* [2018] UKFTT 156 (TC), which HMRC has appealed.)

Inco Europe

If its primary and secondary arguments were rejected, HMRC pointed to the fact that the TMA 1970 does not permit HMRC to make discovery assessments in certain cases where taxpayers have not filed SATRs, and that this outcome is anomalous and absurd. The UT disagreed: in respect of different types of tax charges, Parliament had adopted different types of assessment mechanisms. Even had Parliament erred in failing to notice that s 29 was not apt to empower HMRC to assess taxpayers where they had

not filed SATRs: 'This was not simply a case of Homer, in the shape of the draftsperson, having nodded (Inco Europe at p 589). Homer would have been under a material misapprehension' (para 142). Rather, the UT considered that there were would have been a more fundamental misunderstanding about Parliament's intention in enacting s 29 in its current form, leading to a failure to made adequate provision for assessments to the HICBC to be made outside the self-assessment system (para 143). The UT did not therefore consider that this was the sort of drafting mistake that falls within the principle of *Inco Europe*.

The UT's obiter remarks in respect of the application of the *Inco Europe* principle are also interesting. The UT observed that: 'Whilst we are prepared to accept that from HMRC's perspective the omission was inadvertent, we would not be "abundantly sure"' either of the intended purpose of [FA 2012 Sch 1] as it might affect [TMA 1970 s 29], or as to the substance of the provision that Parliament would have made' (para 143).

In relation to the 'abundantly sure' requirement, the UT noted that by amending TMA 1970 s 7 and including the HICBC on the list of charges falling within step 7 of the ITA 2007 s 23 calculation, Parliament clearly intended that the HICBC should be collected via the self-assessment procedure. But the UT noted that it had been shown nothing in the legislation or other material that demonstrated that Parliament's intention must be taken to have been that additional assessing procedures should be available (para 145).

The UT did not consider that it could be satisfied as to the 'substance of the provision that Parliament would have made' (at para 146). The UT accepted the taxpayer's submissions that Parliament had adopted (broadly) three different approaches to assessment of freestanding charges to tax, namely:

- deeming the charge be in respect of income (e.g. under F(No. 2)A 2005 s 7; see para 87);
- conferring powers on HMRC to make regulations amending TMA 1970 to enable reporting and assessment of tax (e.g. FA 2004 ss 254 and 255 in respect of pensions related charges; see paras 88-90); and
- in respect of the liabilities to income tax listed in ITA 2007 s 32 which do not form part of the income tax calculation prescribed by ITA 2007 s 23, that it had made provision for assessments to be made (but not by self-assessment) in the particular manner prescribed. Some of these mini-codes refer to sections or parts of TMA 1970 as being applied as they are applied to assessments under that Act; some provide their own time limits and some are simply statements that an assessment may be made (see para 91).

The UT also took account of the introduction of TMA 1970 s 28H, i.e. the power conferred on HMRC since 2016 to make 'simple assessments' in cases where a taxpayer has not filed a SATR (see para 147).

In the authors' view, in rejecting all three arguments advanced by HMRC, the reasoning of the UT seems unassailable. HMRC may of course seek permission to put its arguments differently. As matters stand, it is not yet known whether HMRC will seek permission to appeal. It has until the end of July to do so; therefore, at the time of writing, the decision of the UT is not yet final.

What should affected taxpayers do?

If HMRC does not appeal the decision (or if it does and is unsuccessful), discovery assessments issued to taxpayers in the same position as Mr Wilkes are challengeable on the grounds that s 29(1)(a) does not empower HMRC to issue them.

However, there are time limits for bringing appeals against assessments. The FTT has power to dispense with them if HMRC rejects a late appeal, applying the principles established in *Martland v HMRC* [2018] UKUT 178 (TCC).

The prudent course for any affected taxpayers would be now to lodge appeals, seeking the tribunal's permission to appeal out of time if necessary; and to seek a stay pending a final determination of the decision in *Wilkes*. Similarly, for the approximately 400 taxpayers who have already appealed their assessments to the FTT (and where the tribunal found for HMRC, for example in *Wiseman* and *Haslam*), the prudent approach would be to make a late application for permission to appeal to the UT, seeking permission to appeal out of time and also seeking a stay pending a final determination of the appeal in *Wilkes*. Given the number of appeals involved (and the consequent difficulties in case management) and the need for consistency of treatment, HMRC and the tribunals will likely agree to group cases, with representative lead cases selected from among them.

However, the authors stress that those who have been charged to tax (or indeed to penalties) because of the HICBC are not all in the same boat. Taxpayers should not incur the cost appealing (or seeking permission to appeal out of time) if the decision in *Wilkes* cannot improve their position.

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What this case did not decide

The decision of the UT does not mean recovery of amounts from HMRC for *all* taxpayers assessed to HICBIC. There are important limits to the degree of reliance that can be placed on the decision, principally stemming from the fact that the decision does not mean that the HICBC ceases to be due: taxpayers are still required to notify liability under TMA 1970 s 7 and a failure to do so may result in the assessment of penalties. As recognised by the UT, HMRC does, subject to time limits, have different powers which it can exercise to collect the tax due.

So, for those taxpayers who were issued with discovery assessments:

- The decision will not assist any taxpayers who *did* file a SATR but who failed to self-assess to HICBC. Any taxpayer who filed a SATR but who did not self-assess to the HICBC can properly be assessed by HMRC under s 29(1)(b) (subject to the usual protections and time-limits).
- The decision may not assist any taxpayer who did not file a SATR, but where there is 'income' which was not assessed, if there is an open appeal to the FTT: in appropriate cases, HMRC may invite the FTT to exercise its power under TMA 1970 s 50(7) to increase the amount of the assessment to include the HICBC.
- Most importantly, the decision may not ultimately assist those taxpayers who have been issued with assessments under s 29(1)(a), where HMRC is still in time to issue HMRC 'simple assessments' (under TMA 1970 s 28H), i.e. for tax years from 2016/17 (HMRC is unable to use

s 28H for tax years prior to 2016/17). In other words, if a taxpayer were to successfully appeal a discovery assessment, HMRC could simply assess that taxpayer under s 28H (subject to time limits).

There is nothing to suggest that the time limits that apply to discovery assessments do not also apply to simple assessments under s 28H. The ordinary time limit is four years. If the loss of tax is brought about 'carelessly' the time limit is extended to six years. But even if HMRC accepts that the loss of tax is not brought about 'carelessly', they might still be in time to make simple assessments for the tax years 2016/17 and 2017/18; this is because a 20 year time limit applies not only if the loss of tax is brought about deliberately, but also if the loss of tax is attributable to a failure to comply with an obligation under TMA 1970 s 7 (s 36(1A)(b)).

It remains to be seen whether HMRC would seek to assess any taxpayer beyond the six-year time limit. Where the taxpayer has in fact notified HMRC of their liability (for example, in response to a 'nudge' letter), it is difficult to see how it can properly be said that the loss of tax is attributable to a failure to comply with an obligation under s 7: the loss of tax could more realistically be regarded as attributable to HMRC's failure to issue a notice under s 8 (assuming HMRC had been within time to do so).

Penalties

Similarly, the duty under s 7 to notify remains untouched by *Wilkes*. Penalties were not in issue in *Wilkes* and the judgment does not affect the current position (*M Francis v HMRC* [2021] UKFTT 263 (TC) is representative of the issues pertaining to penalties on an appeal to the FTT).

This will prove disappointing to many taxpayers: as at 7 May 2021, HMRC has issued 168,838 penalties for failure to notify chargeability to the HICBC.

However, after sustained political and press campaigns, HMRC has reviewed the penalties for 35,096 taxpayers, and it has cancelled penalties for 4,844 of those: a total of 6,156 penalties have been cancelled by HMRC as a result of taxpayers having a reasonable excuse for the failure to notify. Additionally, there have been internal statutory reviews by HMRC in 711 cases, and 382 appeals have been made to the FTT (according to HMRC's statistics, see bit.ly/3x6ClkQ).

What next?

Many taxpayers in a similar position to Mr Wilkes will be hoping that HMRC will voluntarily approach them to offer refunds. However, HMRC may regard this as contrary to its primary duty to collect all the tax that is due. Much may depend on how the tribunals will approach the question of extending time limits for appealing assessment.

One hopes that HMRC is working with Treasury officials behind the scenes to improve the design and collection of the HICBC. After all, it is in nobody's interest for taxes to be badly designed and difficult to collect. ■

The authors, together with Richard Vallat QC, acted pro-bono for the taxpayer before the UT.

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▶ Cases: *HMRC v J Wilkes* (7.7.21)