

Case No: A3 2009/2226

Neutral Citation Number: [2010] EWCA Civ 893

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

SIR JOHN LINDSAY

[2009] EWHC 2306 (Ch)

ON APPEAL FROM THE SPECIAL COMMISSIONERS
(MR JOHN CLARK)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 30 July 2010

Before:

LORD JUSTICE MUMMERY

LORD JUSTICE LLOYD

and

SIR MARK WALLER

Between:

WILLIAM STOCKLER

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS

Respondent

Conrad McDonnell (instructed by **Stockler Brunton**) for the **Appellant**

Akash Nawbatt (instructed by **the Solicitor for HM Revenue and Customs**)
for the **Respondent**

Hearing date: 26 May 2010

Judgment

Lord Justice Lloyd:

Introduction

1. Mr Stockler, the appellant, was the representative partner of a firm of solicitors practising under the name Stockler Charity. Since the period relevant for these proceedings one of the three partners, Mr Charity, has retired, and there has since then been a firm under the name Stockler Brunton. The present appeal arises from the tax affairs of Stockler Charity and of Mr Stockler himself. I will refer to the respondent as HMRC, regardless of whether, at the material time, that was the correct label. (I will also use the same label, in referring to statutory provisions, even though in some cases the reference should be to an officer of HMRC.)
2. The appeal is brought, with permission of Rimer LJ, against a judgment of Sir John Lindsay given on 22 September 2009, [2009] EWHC 2306 (Ch), itself given on appeal from a decision of the Special Commissioner (Mr John Clark) released on 20 February 2009 (Spc00739). The proceedings arise from the consequences of previous litigation. I will tell the story in outline.
3. Stockler Charity submitted partnership returns in respect of income tax for various periods of account. HMRC took the view that some of these were incorrect. In September 2005 they amended the partnership return for three periods, so as to exclude deductions which they said could not properly be made. They did not proceed to amend Mr Stockler's own return consequentially.
4. Stockler Charity appealed against these amendments to the Special Commissioners. Their appeal was dismissed on 7 December 2006, by Sir Stephen Oliver Q.C. and Dr Brice. They appealed further to the High Court. On 17 May 2007 Stockler Charity made an offer under CPR Part 36 to HMRC to settle the appeal. The terms of the offer were as follows:
 - i) HMRC will withdraw the amendments of the partnership's returns for certain specified years.
 - ii) The Appellant (Stockler Charity) will pay (within a given time) "the aggregate amount of income tax assessable on the partners of the Appellant in consequence of the decision of the Special Commissioners", the subject of the appeal, subject to certain uncontroversial adjustments.
 - iii) The Appellant will pay, within the same time, interest at the statutory rates on the sum so payable.
 - iv) The Appellant will pay HMRC's costs of the appeal up to acceptance of the offer.
5. On 25 May 2007 HMRC accepted the offer. It sent the appropriate notice under cover of a letter in which it said that acceptance of the offer was "entirely without prejudice to any penalty determination which may follow hereafter", penalties not being in issue in the proceedings. The sum of principal due was agreed in due course as £76,508.75; together with interest at statutory rates the agreed sum was £122,731.77. This was paid (by Mr Stockler), and the amendments to the partnership returns were

withdrawn. There were some technicalities about the process of withdrawal but, fairly, HMRC did not rely on any of those to detract from the position that, as required by the terms of the Part 36 offer, the amendments had been withdrawn.

6. I doubt that it is relevant or admissible, but there had in fact been previous discussions between the parties in the course of which HMRC stated that they expected to levy penalties in consequence of the under-declaration of income, and Mr Stockler said that he would not agree to pay anything by way of penalty.
7. On 16 October 2007 HMRC issued a penalty determination in respect of Mr Stockler in respect of incorrect returns of his liability to tax for three years, the penalty being 70% of the tax due, and amounting to £53,555.
8. Stockler Charity applied to the High Court seeking an order precluding HMRC from levying penalties based on the amendments which had by then been withdrawn. The application came before Warren J, who refused it on the grounds that the proper recourse was an appeal to the Special Commissioners: [2007] EWHC 2967 (Ch). Mr Stockler therefore appealed to the Special Commissioners. Mr Clark treated the hearing before him as devoted to a preliminary issue, namely whether HMRC had power to raise a penalty determination. As he held that it did, other issues could arise, as to quantum, but those were held over pending appeal. His decision led eventually to the present appeal.

The issue on the appeal

9. I will need to set out several provisions of the Taxes Management Act 1970 (TMA). At the heart of the case is section 95 which is the provision relied on as creating liability to a penalty. The relevant part is as follows:

“95(1) Where a person fraudulently or negligently–

(a) delivers any incorrect return of a kind mentioned in section 8 or 8A of this Act (or either of those sections as extended by section 12 of this Act), or

(b) makes any incorrect return, statement or declaration in connection with any claim for any allowance, deduction or relief in respect of income tax or capital gains tax, or

(c) submits to an inspector or the Board or any Commissioners any incorrect accounts in connection with the ascertainment of his liability to income tax or capital gains tax,

he shall be liable to a penalty not exceeding the amount of the difference specified in subsection (2) below.

(2)The difference is that between–

(a)the amount of income tax and capital gains tax payable for the relevant years of assessment by the said person (including any amount of income tax deducted at source and not repayable), and

(b) the amount which would have been the amount so payable if the return, statement, declaration or accounts as made or submitted by him had been correct.”

10. On behalf of Mr Stockler, Mr McDonnell argues that “the amount of income tax ... payable for the relevant years of assessment by” the appellant has to be determined by reference to what is his liability under the relevant legislation, which depends on the amount of a subsisting assessment. He does not dispute that the £122,000 odd was due from Mr Stockler to HMRC, but he says it was not “income tax ... payable for the relevant years of assessment”, and was therefore not to be brought into account under section 95(2)(a). Accordingly, he argued, the amount under section 95(2)(a), following the withdrawal of the amendments, is the same as the amount under section 95(2)(b), and that the maximum penalty is therefore nil.
11. The Special Commissioner and Sir John Lindsay both disagreed with this, but Mr McDonnell has mounted a substantial challenge to their conclusions and to HMRC’s position. In order to address the points arising it will be necessary to refer to various provisions of TMA, and to some decisions of this court. I will start with the legislation.

The relevant legislation

12. For this purpose it is necessary to look at the legislation about self-assessment both for individuals and for partnerships. Before 1996 self-employed persons would put in a tax return, on which HMRC would make an assessment. The assessment set out the taxpayer’s liability, subject to any appeal. The introduction of the self-assessment system in 1996 changed all of that.
13. Under TMA section 8 persons chargeable to income tax (and capital gains tax, but I need not mention cgt separately in future) for a year of assessment may be required by notice to make a tax return containing information specified in the notice, reasonably required for the purpose of establishing the amounts in which the person is chargeable to income tax for the relevant year.
14. Correspondingly, where a trade, profession or business is carried on by a partnership, HMRC may give notice to the partnership, or to any partner, requiring a tax return, under section 12AA. By section 12AB every partnership return is to include a partnership statement. This must state amounts of income or loss from each relevant source which has accrued to or been sustained by the partnership and, in the case of each of the partners, the amount which is equal to his share of the income or loss.
15. Returning to section 8, by sub-section (1B) a person who is a partner in a trade, profession or business must include in his return under section 8 the amount which, in any relevant partnership statement, is stated to be equal to his share of any income or loss for the relevant period.
16. By section 9(1), any return under section 8 must include a self-assessment, defined as follows:
 - “(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 [tax credits]”

17. Tax returns by individuals may be altered in various circumstances. It is not necessary to go into those, because there was no such alteration in this case. Instead, action was taken in relation to the partnership return. Under section 12ABA the taxpayer may amend a partnership return within 12 months after it was filed. Under section 12ABB HMRC may amend a partnership return to correct obvious errors. Section 12AC provides for HMRC to enquire into a partnership return on notice within the time allowed by the section.
18. More relevantly, section 29 provides for HMRC to make an assessment as regards a taxpayer on the grounds of the discovery that (among other things) income that ought to have been assessed to income tax has not been so assessed, the assessment being in the amount to be charged in order to make good to the Crown the loss of tax. This can only be done if two conditions are satisfied, of which one is that the situation is attributable to fraudulent or negligent conduct on the part of the taxpayer or someone on his behalf.
19. Section 30B provides an equivalent power in relation to errors in a partnership statement, subject to corresponding conditions. The power is to amend the partnership return under section 30B(1). If that is done, notice is to be given to amend the return under section 8 of each of the partners: section 30B(2). The power under section 30B(1) was exercised in the present case so as to make the amendments of the partnership return referred to at paragraph [3] above. As there noted, the requirement to amend the returns of individual partners was not carried out.
20. The hearing before the Special Commissioners established that the amendments to the partnership returns had been properly made, though the matter remained in issue by reason of the appeal to the High Court.
21. Reverting to the statutory provisions, section 59B(1) of TMA provides as follows:
 - “(1) Subject to subsection (2) below, the difference between—
 - (a)the amount of income tax and capital gains tax contained in a person’s self-assessment under section 9 of this Act for any year of assessment, and
 - (b)the aggregate of any payments on account made by him in respect of that year (whether under section 59A of this Act or otherwise) and any income tax which in respect of that year has been deducted at source,shall be payable by him or (as the case may be) repayable to him as mentioned in subsection (3) or (4) below but nothing in this subsection shall require the repayment of any income tax treated as deducted or paid by virtue of [various specified provisions]”

22. Section 59B(3) and (4) specify when the difference is payable. Section 59B(5) deals with timing when an assessment or self-assessment has been corrected or amended:

“(5) An amount of tax which is payable or repayable as a result of the amendment or correction of a self-assessment under—

(a) section 9ZA, 9ZB, 9C or 28A of this Act (amendment or correction of return under section 8 or 8A of this Act), or

(b) section 12ABA(3)(a), 12ABB(6)(a), 28B(4)(a), 30B(2)(a), 33A(4)(a) or 50(9)(a) of this Act (amendment of partner’s return to give effect to amendment or correction of partnership return),

is payable (or repayable) on or before the day specified by the relevant provision of Schedule 3ZA to this Act.”

23. Schedule 3ZA specifies various time limits for different cases. By paragraph 9, if an amount of tax is payable as a result of the amendment of a self-assessment under section 30B(2), after the amendment of the partnership return, the relevant amount is payable within 30 days of the giving of notice under section 30B(2)(a).

24. Thus, in the ordinary way, if a partnership return is amended under section 30B(1), the returns of the individual partners will be amended under section 30B(2), notice being given for that purpose, and additional tax will become payable 30 days later. That had not happened in the present case by the time of the settlement of the appeal proceedings, and it never did. Presumably, if the appeal had continued and been dismissed, then subject at any rate to any further appeal, HMRC would have got round to proceeding under section 30B(2), and the additional amount would have been payable by Mr Stockler within the 30 day period.

25. Reference was also made to some other provisions said to be relevant to the issue. One is section 54 which deals with the tax consequences of agreements compromising appeals to the Special Commissioners (now the First-Tier Tribunal):

“(1) Subject to the provisions of this section, where a person gives notice of appeal and, before the appeal is determined by the Commissioners, the inspector or other proper officer of the Crown and the appellant come to an agreement, whether in writing or otherwise, that the assessment or decision under appeal should be treated as upheld without variation, or as varied in a particular manner or as discharged or cancelled, the like consequences shall ensue for all purposes as would have ensued if, at the time when the agreement was come to, the Commissioners had determined the appeal and had upheld the assessment or decision without variation, had varied it in that manner or had discharged or cancelled it, as the case may be.”

26. The section has other ancillary provisions, but the details do not matter. No such provision applies where the agreement deals with an appeal from the Special Commissioners.

27. Another is section 101 as to evidence:

“An assessment which can no longer be varied by any Commissioners on appeal or by order of any court is sufficient evidence, for the purposes of—

(a) the preceding provisions of this Part, and

(b) the provisions of Schedule 18 to the Finance Act 1998 relating to penalties,

that the amounts in respect of which tax is charged in the assessment arose or were received as stated in the assessment.”

28. We were also referred to section 103 which imposes time limits for penalties. Relevantly it specifies six years after the date on which the penalty was incurred or (if later) three years after the final determination of the amount of tax by reference to which the amount of the penalty is to be ascertained.

The appellant's case

29. On behalf of Mr Stockler, Mr McDonnell submitted that it was not open to HMRC to impose a penalty on his client because the additional sum was not income tax payable by him. The essence of his argument is that income tax can only become due by virtue of an assessment, whether one raised by HMRC or a self-assessment. Other sums may be due to HMRC by agreement, but sums not comprised in a subsisting assessment are not due as tax. Of course, what is due by way of an assessment depends on other substantive provisions as to what are the tax consequences of particular situations, such as, in the present case, the carrying on of a particular trade, profession or business during a particular period. But it is only by the process of assessment that the liability of a taxpayer is crystallised and quantified, and nothing is payable as income tax unless it is the subject of a current assessment.
30. He pointed to the fact that the partners' self-assessments, based on the original partnership return, had shown specified sums as being due from each of them by way of income tax. These sums were due (and were presumably paid) under section 59B(1). A larger sum would have been due from Mr Stockler as a result of the amendment of the partnership return under section 30B if (a) the amendment had been upheld on the appeal and (b) a consequent amendment had been made under section 30B(2) to his own return. Since neither of these things happened, no additional sum was due from him by way of income tax, it was argued, and the withdrawal of the amendments to the partnership return made it impossible for HMRC to proceed under section 30B(2), quite apart from whether to proceed in that way would have been inconsistent with the agreement.
31. He also argued that, although section 101 speaks of an assessment as being “sufficient” evidence for the purposes of penalties, it must mean that it is not only sufficient but also conclusive as to what is due. Otherwise, even though the assessment is no longer capable of being challenged, the taxpayer (or HMRC) might be able to argue that the true position as regards tax due was otherwise. On that basis, on the present facts, he said that the original self-assessments were no longer capable of being varied by any order of the Commissioners or of any court, and they therefore determined the question of what tax was due for all relevant purposes.
32. This is a powerful argument. It has striking consequences in the present case. For some time before the Part 36 offer was made there had been negotiation between Stockler Charity and HMRC about a possible settlement, in which it was made clear for HMRC that penalties would be imposed, so that any payment had to take them

into account, though Stockler Charity did not accept that this was appropriate and would not agree to pay anything by way of penalty. In HMRC's letter enclosing the form accepting the Part 36 offer, it was said in terms that "acceptance of the Part 36 offer is of course entirely without prejudice to any penalty determination which may follow hereafter. Penalties are not, of course, in issue in the present proceedings." Nevertheless, the argument is that this is the consequence of acceptance of the Part 36 offer and of its implementation by the withdrawal of the amendments to the partnership returns.

33. Thus, if Mr McDonnell is right, his client agreed to pay the whole sum claimed by way of tax and interest, and HMRC's costs to date, but obtained the advantage that, even though HMRC had made it plain that they intended to impose penalties and there was nothing in the agreement to exclude that in terms, he has managed to get HMRC to act, by agreement, in a way which precludes them from any such imposition.

The respondent's case

34. For HMRC Mr Nawbatt did not accept Mr McDonnell's proposition that the sum due by virtue of the agreement created by the making and acceptance of the Part 36 offer was not due and payable as tax. Both the Special Commissioner and Sir John Lindsay rejected this proposition on the part of Mr McDonnell, and held that Mr Nawbatt's arguments were correct.
35. Mr Clark did not accept that self-assessment was the only way to arrive at the amount of income tax payable, for the purposes of section 95, and said that "the amount which the taxpayer is actually required to pay can be arrived at by way of contract settlement or some other agreement with similar effect". He considered that the section looked at the tax properly payable on the basis of the facts as eventually established, which did not, in his judgment, require an assessment. He also rejected the argument that section 101 was an exclusive provision as to how the tax payable could be established.
36. In turn, Sir John Lindsay dismissed Mr Stockler's appeal, and he too rejected the argument that section 101 provided the only way of showing what was due by way of tax. He held that the Part 36 agreement established, by agreement, that the sum in question had been payable as an amount of tax, and was therefore payable for the purposes of section 95(2)(a).
37. Mr Nawbatt argued that both decisions below were correct, and that section 95(2)(a) is not only concerned with tax payable as a result of an assessment. It can include sums agreed to be due by way of tax as between the taxpayer and HMRC, even absent the formality of an amended assessment. I will deal later in more detail with the decisions of the Special Commissioner and of the High Court.

IRC v Woollen and earlier cases

38. A central element in Mr McDonnell's arguments was the effect of two decisions of this court: *IRC v Nuttall* [1990] 1 W.L.R. 631 and *IRC v Woollen* [1992] STC 944. He argued that these show, in a manner binding on this court, that sums which are agreed between taxpayer and Revenue to be payable by the taxpayer, but which are not the subject of an assessment, are not due and payable as tax. The latter is the

more critical case for present purposes. However, before I turn to either of these two, I must refer briefly to two earlier authorities.

39. In *W H Cockerline & Co v IRC* (1930) 16 TC 1, a point arose in relation to a tax called excess profits duty, as to whether, on particular facts, “all questions as to [the taxpayer’s] liability in respect of duty ... have, in the opinion of the Commissioners, been finally determined”. The taxpayer, Sir William Cockerline, had been the subject of an enquiry as to the relevant duty and other taxes, and on his behalf it had been agreed that substantial further sums were due, which were paid, and later a large sum was paid in settlement of a claim for penalties. There had been no assessment for the additional sums of tax, nor any equivalent in respect of penalties. Nevertheless the Commissioners served notice after this that all questions had been finally determined. The taxpayer appealed against the notice. On his behalf Mr Wilfred Greene made a submission, characterised by Lord Hanworth MR as being coloured by a warmth of feeling about it, that the sums paid by way of additional tax could not properly have been paid without an assessment, and that it was altogether wrong that there should be any inroad “upon the rights of the subject that there should be any sum ever accepted from the subject in discharge of a liability in respect of which there had not been the assessment or paper imposing the assessment served upon him”. He rejected that argument, as did Slesser LJ, who at page 26 of the report observed in terms that it was open to the Crown and a subject to come to an effective agreement as to the sum to be paid without the formality of an assessment. Romer LJ also agreed.
40. The decision in that case is not in point, because of the special legislation. It seems to me that the observations as to the lack of any need for an assessment have been affirmed by later decisions to similar effect, where the matter is one of decision, not just comment.
41. We were also shown *Khan v First East Brixton General Commissioners* [1986] STC 331, a decision of Harman J in which he spoke at page 333 about tax becoming payable on a due date following an assessment. No issue arose in that case about a voluntary agreement, and while I do not in any way question the decision, it does not assist on the point at issue on this appeal.
42. In *IRC v Nuttall* an agreement had been reached at the conclusion of a back duty investigation, under which the taxpayer undertook to pay certain sums. The first sum due was paid but not the rest. HMRC sued the taxpayer for the agreed sums. He resisted the claim on the basis that it was ultra vires HMRC. The Court of Appeal held that this defence was not justified. Parker LJ said at page 200 of the report:

“It is pointed out that there are two specific powers there to compound proceedings, but there is no such specific power in the case of the tax itself. They apply only to interest and to penalties. But a power to compound proceedings for a penalty, whether before or after judgment, or at any stage, or in respect of culpable interest, appears to me to permit an agreement whereby the Revenue on some terms are prepared to release their undoubted power to enforce interest and penalties. If they choose in the exercise of their duties of care and management to say ‘we will release you from the penalties and the culpable interest to which you may otherwise be exposed on condition that you pay us a sum in respect of past tax’, that appears to me to be a compounding of the proceedings. There is included in it, of course, a release from further proceedings for the tax. But if that be the way that, in

the judgment of the Revenue, they can best collect the tax and the penalties for the benefit of Her Majesty, I can see no reason why they should not. Indeed the matter may in the end be as simple as this. If there is a power to enforce there must also necessarily be a power for good consideration to accept some lesser sum. The Revenue of course have no power to refrain from collecting tax which is due, but these agreements are all made in a situation where the actual tax recoverable has not yet been quantified. The liability is in existence but the machinery which is involved in the collection and enforcement has not yet run its course, either at all or only partly.”

43. He then referred to and quoted from Lord Hanworth’s judgment in *Cockerline*, and went on:

“A little lower down Lord Hanworth observes that it would be unfortunate if the subject were not able to make an agreement unless and until some assessment had been made. Counsel for the taxpayer says, entirely correctly, that that is not authority against him because the point did not specifically arise in that case. But it appears to me that if the Revenue are to have the necessary powers, as they are under section 1 of the 1890 Act [the Inland Revenue Regulation Act 1890], it is an incidental power to enable them to enter into an agreement to compromise an overall situation consisting partly in outstanding tax, partly in a potential liability to culpable interest and partly in potential liability to pay penalties if by that means they consider they can best recover and manage the tax which is committed to their care.”

44. Ralph Gibson LJ and Bingham LJ agreed. The latter said this, at page 205, on which Mr McDonnell relied:

“It would seem to me extraordinary, and also regrettable, if the Revenue could not achieve by agreement that which it could undoubtedly achieve by coercion. The submission that it could not, as counsel for the taxpayer acknowledges, runs counter to the habitual practice of the Revenue recognised by the recent Royal Commission without query or criticism. But counsel fairly points to the fact that although the legislation expressly authorises the Revenue to mitigate and compound claims for penalties and default interest, it does not expressly authorise the Revenue to compromise claims for back duty save where an assessment has been made and appealed against.

I would prefer, if necessary, to accept this legislative omission as an anomaly of drafting than be compelled to a result I regard as offensive to good sense and subversive of the beneficial present practice. But there is, I think, no anomaly. The power to make agreements with taxpayers for the payment of back duty, even in the absence of assessment and appeal, is in my view a power necessary for carrying into execution the legislation relating to Revenue within the meaning of section 1 of the 1890 Act. It is, of course, a power to be exercised with circumspection and due regard to the Revenue’s statutory duty to collect the public revenue. But if in an appropriate case the Revenue reasonably considers that the public interest in collecting taxes will be better served by informal compromise with the taxpayer than by exercising the full rigour of its coercive powers, such compromise seems to me to fall well within the wide managerial discretion of the body to whose care and management the collection of tax is committed. Such informal compromise deprives the taxpayer of the *locus poenitentiae* provided by section 54(2), and the right to re-open assessments under section 33, but it

protects him against exercise of the Revenue's more draconian enforcement powers (e.g. under sections 61 and 65) and often, as here, against further liability for penalties and default interest. I have no hesitation in holding such an agreement, properly made, to be binding. There is accordingly, in my opinion, no arguable defence to the present claim."

45. That case, therefore, established that HMRC could reach a binding agreement with a taxpayer under which sums were payable and could be enforced, even though no assessment had been issued in respect of the amounts agreed to be paid. The last case in the series, *Woollen*, had to consider the consequences of such an agreement.
46. In *Woollen* a taxpayer and three companies of which he was a director had entered into an agreement with HMRC, settling a back duty investigation, by which he and the companies agreed, jointly and severally, to pay by instalments a sum expressed to be payable in respect of unpaid duties together with interest and penalties, in consideration of no proceedings being taken against any of them for the duties or interest or for any penalties. A small amount was paid. The three companies went into administrative receivership. HMRC made no preferential claims in the receiverships. They sued the taxpayer for the balance outstanding. He contended that HMRC had been entitled to claim as preferential creditors for the sums owing from the companies, and that because they had failed to do so, he was discharged of his liability as guarantor for the companies' liabilities. The court dismissed this contention, holding that HMRC was not entitled to rank as a preferential creditor for the sums due under the agreement, because, although due, they were not due as tax.
47. Dillon LJ assumed in favour of Mr Woollen that he was to be treated as a surety for the liabilities of the three companies under the agreement, and recognised that HMRC would have been entitled to put forward claims to the effect that certain sums, if due as tax, were to be treated as preferential in the receivership. However he dismissed Mr Woollen's appeal, for reasons set out in the following passage, taken from pages 947-8 of the report:

"But apart from that I take the view that the practice of the Revenue not to claim as preferential amounts claimed under investigation settlement agreements is a valid practice in law, because any claim to treat as preferential such sums under a settlement agreement in the form of that we have in the present case, which is a standard Revenue form, would be invalid.

The validity of the practice of the Revenue in settling claims for outstanding tax and possible penalties and interest by investigation settlement agreements such as that in the present case was upheld by this court in *IRC v Nuttall* [1990] 1 WLR 631. They did not there need to go into the precise points we have here but there are certain observations which are helpful.

As I see it, when a settlement agreement of this type is entered into, the Revenue have a new cause of action, namely, a cause of action for the sums agreed to be paid by the agreement according to the terms of that agreement. Thus immediately after entering into the agreement, the Revenue could not have sued for anything until the first instalment became due under the terms of the agreement. If that instalment was not duly paid within 30 days of the date of the letter notifying acceptance of the offer, the only remedy available to the Revenue would have been to sue for the amount of that instalment by an action in debt, presumably in the Queen's Bench Division. There could be

no question of seeking enforcement by levying distress or by proceedings in the Magistrates Court under s 61 or s 65 of the Taxes Management Act, as Bingham LJ points out ([1990] 1 WLR 631 at 643–644) in the *Nuttall* case. There are observations of Parker LJ ([1990] 1 WLR 631 at 638) to the same effect.

Again, if the position were to be that when the Revenue decided to bring proceedings for the unpaid balance at the end of the time for the making of the final payment there had been substantial payment of earlier instalments or payments on account, there would be no question on this form of agreement of the Revenue going back to claim enforcement by the procedures of distraint in so far as the sum due could be traced back by some process of apportionment of the payments made under the agreement and of the sums deducted under the agreement itself in respect of the repayments and repayment supplements due to the taxpayer and the Aberdeen company. All that could be enforced would be the balance due under the agreement.

It must necessarily follow, in my judgment, that the Revenue practice is right, that they had no power to rank preferentially in respect of the sums due by the two companies, which were parts of the tax included in schedules 3 and 4 to the offer, which was part of the investigation settlement agreement. They had lost their identity as income tax assessed on the company but were merely parts of a global sum which was not in itself assessed income tax.”

48. Nolan LJ, with his particular expertise in tax matters, agreed. He identified the crucial question in the appeal as being whether, given that the obligations of the companies were to pay the sums for which the settlement agreement provided, those sums could be taken to have retained the character of the duties, interest and penalties described in the document by which the taxpayer and the three companies offered to settle their liabilities. The argument for Mr Woollen had been that they did and that they must be taken to include a particular amount specified in the offer document as corporation tax unpaid by one of the companies for a particular year, pointing out that the sums were described in the offer document as being payable in respect of the duties referred to therein and also in respect of interest and penalties payable on such duties. He cited extensively from the judgment of Parker LJ in *Nuttall* and said, of a passage shortly before that which I have quoted at paragraph [42] above, that he was there “saying clearly that the sum paid under the contract is a payment made in place of tax”. After quoting the passage which I have myself already quoted, Nolan LJ went on as follows:

“Thus here again, as it seems to me, what is being said is that there is a distinction—narrow it may be but crucial in principle—between what the Revenue collect under the contract and what they might otherwise be entitled to collect under the statute.

Tax liability can only originate from a statute. It cannot originate from a contract. Under the special provisions of section 54 tax liability duly originating from an assessment under the statute can by special statutory provision be determined by agreement. Indeed, most assessments, without any need for a formal appeal, are assessments made by agreement between the taxpayer and the party. It is true still, by and large, to say that the people of this country are taxed by consent. But it is a very different thing, it seems to me, to attribute to the instalments payable under the contract in the present case the quality as to any part of tax or interest or penalties. No assessment of

the tax liability is necessarily made in these cases at all and if an assessment is made, as we are told it has been in the present case, what is payable under the agreement is not the result of a final determination of the statutory claim but a compromise between the parties in their contractual capacity.”

49. He concluded by saying this:

“By the same token the sums due to the Revenue from the companies after the settlement agreement had been made were, in my judgment and could only be properly regarded as, sums due in discharge of a contractual liability and not sums in respect of any part of which a preferential claim could be made on the grounds that they were tax.”

50. Hirst LJ agreed. He said, succinctly, that the effect of the settlement agreement was that “the Revenue irrevocably released their previous claim to tax, interest and penalties, as described in the four schedules, and obtained in substitution therefore the contractual right to be paid the specified periodic instalments as debts due jointly and severally from the taxpayer and his three companies”, and that accordingly Mr Woollen’s “liability under the agreement sounds in debt and not in tax”.

51. So, Mr McDonnell submitted, the sums payable under the agreement created by the acceptance of the Part 36 offer in the present case were undoubtedly due, and the liability could have been enforced if they had not been paid within the period stipulated, but they were not due or payable as tax. Therefore, they were not to be taken into account in any reckoning under section 95A(2)(a) of the amount of income tax payable for the relevant years of assessment, because they were not income tax payable, for those or any other years.

52. This is a powerful argument. As I have said, it was not accepted by the Special Commissioner or in the High Court.

The decisions of the Special Commissioner and the High Court

53. The Special Commissioner said at paragraph 89 that he did not accept that self-assessment is the only way of arriving at the amount of income tax payable for a given year. He held that it could be arrived at by way of a contract settlement or some other agreement with similar effect:

“Section 95(2)(a) is looking at the tax properly “payable” on the basis of the facts as eventually established; it does not require the process to be carried out by way of an assessment.”

54. Later, at paragraph 95, he referred to *Woollen* and said that he did not think that the Court of Appeal in that case was intending to treat sums due under a contract settlement between taxpayer and HMRC as being for all purposes something other than “tax”. In the next paragraph he said:

“Whatever the means of collection and enforcement, and whatever limits on HMRC’s powers for those purposes, the liability to HMRC must remain one in respect of “tax”; given HMRC’s collection and management functions, what other explanation would there be for the liability arising?”

55. On appeal to the Chancery Division, Sir John Lindsay first considered the case of *Nuttall*. At paragraphs 25 to 26 he said this:

“25. ... I read *Nuttall* as confirming that there is a wide managerial discretion in HMRC permitting agreement, even of liability that would otherwise be determined only by formal assessment under the machinery of relevant statutory provisions, and that when such an agreement is properly made it will be binding on its parties.

26. Pausing at this juncture, and assuming that the Part 36 offer and acceptance represents an agreement properly made, I see, as yet, no reason why it should not be taken to have established an additional sum payable within the meaning of s.95(2)(a) notwithstanding that no assessment exists to fix it.”

56. He then referred to the various statutory provisions relied on and examined the agreement in fact reached in this case. He rejected Mr McDonnell’s argument that section 101 had the effect of excluding evidence of the agreement reached in the present case as to the aggregate amount of income tax assessable in consequence of the holding that there had been a negligent insufficiency in the statement of the partnership’s income. At paragraph 33 he said that although the original (and by then no longer amendable) assessment was sufficient evidence, it did not preclude evidence that further sums had been agreed to be payable. He looked at the actual agreement and held that it showed that there was a substantial difference between the sum paid under section 95(2)(b) and the sum payable under section 95(2)(a).

57. He then turned to *Woollen*. At paragraph 39 he drew three propositions from that case of relevance to the present case.

- i) It illustrates that taxpayers may agree their liability with HMRC in a binding way even in respect of assessable taxes and penalties; no assessment is necessarily made.
- ii) Nothing in *Woollen* precludes a sum being “payable” as tax for the purposes of section 95(2)(a) yet being, if it is unpaid, recoverable only as a contractual debt. On that basis he did not see it as helpful to Mr Stockler or his firm to say that the £122,731.77 would not have been recoverable as tax; “it had by agreement been payable as an amount of tax and payability is what section 95(2)(a) is concerned with”.
- iii) Nolan LJ’s reference to section 54 TMA deals with the case where there has been an assessment but where it had been appealed and where agreement is reached before the appeal is determined by the Commissioners. In the present case so far as concerns the £122,731.77 there was eventually no assessment and the agreement was made after the first decision by the Special Commissioners. “One cannot, in my view, jump from the express provisions made as to agreements within section 54 to conclude, as would be contrary to *Nuttall*, that no other kinds of agreement between taxpayer and HMRC should be either intra vires or enforceable.”

58. For these reasons, and more generally because he found no error of law in the Special Commissioner’s decision, he dismissed the appeal.

Discussion

59. It is not in dispute that HMRC can come to an agreement with a taxpayer under which the latter is obliged to pay to HMRC a sum of money, and that this agreement can be enforced against the taxpayer even if the sum in question is not reflected in any assessment to tax. Sir John Lindsay's first and third propositions set out in paragraph [57] are common ground. Such an agreement can be reached in satisfaction of liabilities to tax and to interest on tax, whether or not also for penalties. There is no difficulty in HMRC coming to an appropriate agreement with a taxpayer, so long as both parties are willing. The effect of any agreement reached is to be determined primarily by examining its terms, as with any agreement. If Mr McDonnell is right in the present case, the moral for HMRC is to be more careful as to the terms of any agreement they may reach in future, and to look in the mouth not only a Part 36 offer but also any other offer of agreement, in case it may have unintended consequential effects. But for the provision for withdrawal of the amendments to the partnership statement, the agreement in the present case would not have been arguable as precluding the imposition of penalties.
60. In the case, which I assume is more common, of an agreement in settlement of an appeal to the Special Commissioners (now the First-Tier Tribunal), section 54 governs the effect of the agreement, though subject to special provisions including a right for the taxpayer to withdraw. Once the proceedings have gone beyond this first level, there is no such provision, and the effect of the agreement depends on the general law of contract, and on the application of general tax law so far as relevant.
61. The agreement in the present case consisted of the Part 36 offer and its acceptance. The latter was unqualified, so all turns on the offer. The qualified terms of HMRC's letter enclosing the acceptance form are not relevant, any more than are the positions taken by the parties in their previous discussions about the possibility of settlement.
62. It seems to me that the effect of the offer, once accepted, was that Stockler Charity was obliged to pay to HMRC the relevant amount, namely the aggregate amount which would be assessable on the partners of Stockler Charity as a result of the decisions of the Special Commissioners, plus interest at the statutory rates on that sum, and costs as specified. In return HMRC agreed to withdraw (and did eventually withdraw) the amendments to the partnership returns of Stockler Charity for the three years mentioned in the offer.
63. As a result of the withdrawal, there was no subsisting amendment to the original partnership return, and there never had been an amendment to the individual partners' returns despite the mandatory terms of section 30B(2)(a). The only way in which there could have been an assessment giving rise to an obligation to pay tax was by way of such an amendment to the individual returns of the partners. Such an amendment could no longer be made after the withdrawal of the amendments to the partnership returns. Thus, in terms of the ordinary processes of enforcement of tax liabilities, nothing could have been done, after the withdrawal, to make any of the partners of Stockler Charity pay additional tax following the Special Commissioners' decision.
64. On the other hand, as regards tax, interest and costs, this did not put HMRC at any disadvantage because the agreement provided for the payment in full of the relevant

amounts, subject to quantification. The only outstanding question was a liability to a penalty. The agreement did not cover this expressly, by way of inclusion or exclusion. The Special Commissioner expressed the view that, in these circumstances, the agreement did not prevent HMRC from seeking to impose a penalty. I agree that it did not have that effect by any direct or express provision, but equally it did not preserve expressly any power to impose a penalty. It seems to me that in this respect the agreement is neutral on the point. The real issue is whether the withdrawal of the amendments to the partnership statement, leaving standing the original self-assessments of the partners, however inaccurate, has the effect that a penalty could no longer be imposed.

65. Mr Nawbatt took us through a sequence of correspondence exchanged after the agreement, to show references in Mr Stockler's letters to "tax payable" and the like. I do not see that any of these is admissible in aid of the construction of the agreement. I pay no attention to them.
66. It seems to me, with respect, that neither the Special Commissioner nor Sir John Lindsay allowed to the decision of the Court of Appeal in *Woollen* the full significance that it has. I would accept Mr McDonnell's argument that it shows that sums due to HMRC under a settlement agreement are due and payable, but are not due and payable *as tax*. I understand that the proposition may appear to be odd, that there might be sums due to HMRC from a taxpayer which are due otherwise than as tax (leaving aside such matters as costs of litigation, or indeed penalties). The Special Commissioner articulated this reaction in his paragraph 96 (see paragraph [54] above). However, the combination of the decisions in *Nuttall* and *Woollen* seem to me to show that there may be such sums which are due and payable to HMRC otherwise than as tax. I dare say that they may be accounted for by HMRC internally and to the Treasury as received in respect of tax, but that has no effect on their characterisation as between the party liable to pay under the agreement on the one hand and HMRC on the other.
67. Moreover, with respect to him, I find difficulty with the concept expressed by Sir John in his second proposition mentioned at paragraph [57] above, of sums which are payable as tax although they are not recoverable as tax. If a given amount is payable as tax, it must surely be recoverable as tax; conversely, if it is not recoverable as tax, that must be because it is not payable as tax. That seems to me to be the effect of *Woollen*. I have in mind what Dillon LJ said at page 948 of the report towards the end of each of the second and the fourth of the paragraphs quoted at paragraph [47] above, and also the passages quoted above from the judgments of Nolan LJ and Hirst LJ in the same case. When Hirst LJ said that the appellant's liability "sounds in debt and not in tax", it seems to me that he was holding that the amount in question was not payable as tax, and it was for that reason that it was not recoverable as tax.
68. Mr McDonnell also submitted that the Part 36 agreement created an obligation on Stockler Charity to pay the relevant sums, not an obligation on Mr Stockler as an individual. That is correct, though since Mr Stockler was a partner in the firm at the time he was one of the persons liable under the agreement, against whom, if it had been necessary, it could have been enforced. I do not see that this point adds to Mr McDonnell's main point, although it is consistent with it, in the sense that the agreement created a contractual liability on the partnership, not an additional tax liability on any of the partners individually.

69. The terms of any agreement between a taxpayer and HMRC need to be considered individually. There could well be agreements of a number of different kinds from that reached here. One example would be an agreement which expressly covers tax, interest and penalties. Notwithstanding a concern expressed by the Special Commissioner at his paragraph 91, I see no reason why that should not be fully effective, even if there has not been an assessment. Another different kind, so far from agreeing to withdraw the assessments under which the additional liability arose, would provide for, or at least allow, the issue of a new assessment in an agreed amount, or leave in place an assessment which had already been made and which provided for additional tax to be payable. Such an agreement would not give rise to the issue in the present case, since the sums due under the assessment would be due as tax, under the relevant provisions of TMA. Here, by contrast, the steps which had been taken by HMRC in order to impose the additional liability were agreed to be withdrawn, with the result that it was no longer open to HMRC to take such steps again, nor to take the consequential step of transforming an amendment to the partnership return into amendments to the individual partners' returns and self-assessments, so as to impose on any partner his individual liability to pay additional tax.
70. We had submissions about section 101 of TMA, as to whether its provision that an unalterable assessment is "sufficient" evidence means that it is conclusive. Sir John Lindsay held that it was not (as the Special Commissioner had also held), and that it was open to HMRC to show that a greater sum was due by way of tax. Since, in my judgment, the greater sum, though due, was not due by way of tax, the point does not strictly arise. But the point is of some concern, because if it is open to HMRC to seek to show that an additional sum is in fact due by way of tax, it must also be open to the taxpayer to show that, despite the assessment, a smaller sum is due by way of tax. For my part, I doubt very much that it is open to either party to go behind an assessment which is no longer capable of being varied by (now) the First-Tier Tribunal or by the court, so as to show, in connection with the imposition of penalties, that the tax payable is different from that established by the normal statutory process of assessment.
71. Both Counsel addressed submissions in relation to the text of section 95(2). No issue arises as to sub-section (1) or as to whether its conditions are satisfied. The argument was as to the comparison required by sub-section (2), to calculate a difference which would be the cap on any penalty imposed. Under sub-section (2)(b) the calculation is of the amount of income tax payable on the footing of the original return, that is to say treating it (though in fact inaccurate) as if it had been accurate. In the present case there was no doubt as to that amount, which had already been paid.
72. Turning to sub-section (2)(a), Mr Nawbatt argued that Mr McDonnell's submission amounted to saying that it had to be treated as reading "income tax ... payable *as a result of an assessment* for the relevant years" (the notionally inserted words being shown in italics). Mr McDonnell disputed this. His point was that tax only became payable by virtue of an assessment of one kind or another, or, it might be, some other statutory mechanism. Therefore a provision which speaks of "tax payable" requires that a relevant assessment or other statutory process be identified, as a result of which a given amount of tax is payable.

73. A fair point was made to us, that tax “payable” in both these paragraphs includes tax already paid, for example by deduction at source, or on account under the self-assessment system. It does not seem to me that this affects the argument either way. No timing question arises under this provision. What matters under each paragraph is to work out the total liability of the taxpayer for income tax on each basis: the actual liability (once errors have been corrected), and the liability as it would have been if the figures in the original return had been correct.
74. Of course, in the ordinary way the figure under section 95(2)(a) is likely to be higher than that under paragraph (b). That is because HMRC will have taken action to impose an additional liability on the taxpayer, whether under section 29 for an individual or section 30B for partners, and the consequences of that action, if upheld notwithstanding any appeals, will stand. The different result in the present case stems from the agreed withdrawal of the steps taken by HMRC, despite their having been upheld by the Special Commissioner, and despite the appeal to the High Court being settled on the basis of effective capitulation by Stockler Charity on the figures.
75. In agreement with the Special Commissioner, Sir John Lindsay considered that the agreement reached itself amounted to an agreement that the additional sum (once quantified) was due and payable as tax: see his second proposition drawn from *Woollen* which I have set out at paragraph [57(ii)] above. With respect, I do not agree. It seems to me that the agreement was that the partnership, Stockler Charity, would pay two ascertainable amounts of money to HMRC, the first being what would have been assessable on the partners on the basis of the Special Commissioners’ decision and the second being interest at statutory rates on that first amount. Nothing in the agreement expresses these sums to be tax or interest on tax. They are payable by the partnership, not by the individual partners in respect of the sums due from each of them respectively. The fact that they are calculated by reference to putative assessments to income tax does not of itself make them tax or interest on tax, or agreed to be treated as if they were tax or interest on tax.
76. I therefore disagree with the interpretation of the agreement adopted by the Special Commissioner and by Sir John, as well as disagreeing with them that an agreement, even if in different terms, could create a liability to pay tax, absent a relevant assessment.

Conclusion

77. It seems to me that Mr McDonnell is correct in arguing that the sum of £122,731 agreed to be payable under the agreement was due and payable to HMRC, but was due and payable as a contractual debt, not as income tax or interest on such tax. The agreement could not have made it payable as tax, as a matter of law, and moreover, in my judgment, it did not purport to do so on its true interpretation. The sum would have been due and payable as tax if the amendments to the partnership statement had not been withdrawn and if they had been followed up, as required by section 30B(2) by amendments to the partners’ individual returns, or, at any rate, to that of Mr Stockler. Since the amendments were withdrawn, and Mr Stockler’s own return could therefore not be amended, it seems to me that the additional liability was not and could not be payable as tax.

78. It is evident from the papers before us that this is not what HMRC expected or intended. I dare say that the making (and acceptance) of a Part 36 offer is uncommon in tax litigation. However, there was nothing very special about the terms of the offer which could be said to be attributable to the fact that it was made under Part 36. If it had omitted paragraph 1, there would have been no downside for HMRC in accepting it, but therefore no advantage for Stockler Charity or Mr Stockler in making it. Since that paragraph was included, it was incumbent on HMRC to think carefully about the consequences of agreeing to it. The judge said at paragraph 5:

“It may be, in the light of the later argument, that Stockler Brunton or their client Stockler Charity felt that paragraph 1 of the offer, if accepted, would plainly and without any express mention deny any claim for penalty, a strategy which later events have shown to be fraught with risk.”

79. Evidently the strategy was not without risk, as HMRC have succeeded before the Special Commissioner and in the High Court and, given that Mummery LJ and Sir Mark Waller disagree with me, also in this court. However, as it seems to me the strategy was correct, and it was HMRC that acted without proper caution by accepting the offer.

80. It may be thought that freedom from liability to a penalty is an undeserved windfall for Mr Stockler in this situation. However, the chance, at least, of escaping such a liability was the only advantage that could have been obtained by the making of the Part 36 offer on the particular terms, since the whole of HMRC’s claim for tax, interest and costs was conceded. Moreover, it seems to me right that the imposition of a penalty should be approached with some care, even though this is a civil, not a criminal penalty.

81. I suppose that the facts of the present case are likely to be uncommon, and perhaps unique. I do not imagine that a decision in favour of Mr Stockler opens the way to widespread avoidance of liability to penalties on the part of taxpayers, not least because it is open to HMRC to avoid any such attempts in future by refusing to agree to terms of the kind offered by Stockler Charity. Instead, HMRC can insist on the liability to a penalty being provided for expressly, and either compounded for in the agreement or preserved through maintenance of the necessary assessments (or power to issue them, if not already in place) on the basis of which a penalty determination can be issued.

82. As it is, for the reasons I have given, for my part I would allow this appeal and declare that HMRC did not have power to raise a penalty determination as they purported to do.

Sir Mark Waller

83. I have read in draft the judgment of Lloyd LJ. I gratefully adopt his outline of the facts. It will also be unnecessary for me to quote the relevant sections of the legislation fully set out in his judgment or passages from the relevant authorities again fully set out in his judgment.

84. As is apparent from his judgment, the critical issue on the appeal is whether HMRC, having accepted the Part 36 offer of Stockler Charity, were entitled to charge a

penalty under section 95 of the TMA. He reaches the conclusion that HMRC are precluded from doing so. I, with some diffidence, have reached the opposite conclusion and will give my reasons shortly.

85. Stockler Charity by their Part 36 offer agreed to pay “the aggregate amount of income tax assessable on the partners ... in consequence of the decision of the Special Commissioners” [some £76,508.75 plus interest]. It is not in issue that the firm had “fraudulently or negligently” delivered incorrect returns which would have led to them not paying that sum.
86. By section 95(1) “Where a person fraudulently or negligently [makes an incorrect return] he shall be liable to a penalty not exceeding the amount of the difference specified in subsection (2) below.”
87. Pausing there, on the language of section 95(1), the firm were thus liable to a penalty, but the amount could not exceed the difference specified. I should add that in agreement with Lloyd LJ in my view the terms of the compromise did not preclude HMRC charging a penalty. The question is whether in some way subsection (2) taken together with section 101 places a limit of nil on the difference.
88. Subsection (2) defines the difference which could not be exceeded as the difference between “(a) the amount of income tax and capital gains tax payable for the relevant years of assessment by the said person ... and (b) the amount which would have been the amount so payable if the return ... had been correct”.
89. Subsection (2) accordingly simply limits the amount of the penalty payable. It does not impose the penalty. I do not see thus that it is necessary for there to be any assessment of the tax payable for the relevant years under either (a) or (b) before the limit placed on the amount of the penalty can be calculated. Subsection (2) is simply concerned to establish a limit being the difference between what tax would have been “payable” while a negligent or fraudulent return was in place - i.e. (b) - and what would have been “payable” with an accurate return - i.e. (a).
90. I do not with respect believe that *IRC v Nuttall* or *IRC v Woollen* have any real relevance to the calculation of the limit under section 95(2). An agreement or compromise with HMRC may provide very good evidence as to what was “payable” and thus be relevant in that sense. But it is irrelevant that the compromise itself produces a debt rather than a tax liability. What one is concerned to do is to establish what was “payable” in the two different situations.
91. The terms of the compromise would seem to provide good evidence both of what would have been payable if the incorrect returns over the relevant years had been correct – i.e. (b) under subsection (2) of section 95 - and that which would have been payable if correct returns had been made - i.e. (a) under that subsection - the difference according to the compromise being the amount of £76,508.75.
92. But as I understand Mr McDonnell’s argument, he suggests that since the amendments have been withdrawn under the compromise, (a) and (b) must now be the same by virtue of the terms of section 101.

93. Section 101 is concerned with assessments and what an assessment establishes. HMRC do not rely on any assessment to establish the difference between (a) and (b) of subsection (2) of section 95. They simply demonstrate that the difference between what was “payable” under incorrect returns (b), and on the basis of correct returns (a), was the figure of £76,508. It is Mr Stockler who would seek to rely on the assessment produced as a result of the compromise. His argument has to be that although incorrect returns were put in and that although on the basis of correct returns a larger sum in tax was payable, because by the compromise the amendments were withdrawn, he can rely on the version of the assessment produced by the compromise as conclusive evidence that the difference between (a) and (b) is nil.
94. I cannot accept this latter argument as legitimate. It fails in my view because it overlooks the fact that subsection (2) is concerned to define the limit of a penalty by reference to the difference in tax “payable” with a correct return (a) and tax “payable” by virtue of an incorrect return (b). Subsection (2) is not concerned with whether there has been an actual assessment, and an actual assessment produced as part of a compromise does not provide any evidence of what was “payable” with a correct return as opposed to that which was “payable” with an incorrect return.
95. Furthermore the wording of section 101 is “sufficient”, and although I take Lloyd LJ’s point as to the likelihood that Parliament did not intend assessments to be reopened, I would suggest that it does not follow that the section must be construed so as to allow Mr Stockler to rely on the result of the compromise to effectively contradict the terms of the compromise itself.
96. I would therefore dismiss the appeal.

Lord Justice Mummery

97. I have read in draft the judgments of Lloyd LJ, who would allow the appeal, and of Sir Mark Waller, who would dismiss the appeal, as he agrees with Sir John Lindsay that there was no error of law in the decision of the Special Commissioner (Mr Clark). I am with Sir Mark Waller and the decisions below and would dismiss this appeal.

Section 95 TMA construed

98. Repetition of the facts, law and submissions is tiresome and unnecessary. Lloyd LJ has set everything out in exemplary fashion. I agree with him that section 95 of the TMA is the heart of the matter. I have three points on the section.
99. The first is that its self-evident purpose is to create liability to a penalty on a person who acts fraudulently or negligently in the performance of one or more of the tax tasks specified in subsection (1) and to put a cap on amount of the penalty that can be imposed on the offending taxpayer. The cap is calculated in accordance with subsection (2). The section should, so far as the language allows, be construed to promote that purpose. In ordinary circumstances that purpose would be defeated if the construction adopted prevents HMRC from exercising their discretion to impose a penalty on a tax offender.
100. The second is that, in principle, this taxpayer is liable to a penalty subject, of course, to a cap on the amount. The fact that the taxpayer’s Part 36 offer, as accepted by

HMRC, omitted to mention a penalty does not prevent HMRC from exercising their statutory discretion.

101. The third is that the amount of the penalty must not exceed the difference between the two other amounts specified in section 95(2)(a) and (b) respectively. Three amounts have to be calculated-
- i) The amount of the income tax payable for the relevant years of assessment by the taxpayer: (section 95(2)(a)).
 - ii) The amount which would have been the amount so payable, if the returns submitted to HMRC had been correct: (section 95(2)(b)).
 - iii) The amount of the difference between (1) and (2) and that is the cap on the amount of the penalty to which the taxpayer is liable: (section 95(1)).
102. As Lloyd LJ observes (paragraph [74]) "...in the ordinary way the figure under section 95(2)(a) is likely to be higher than that under paragraph (b). That is because HMRC will have taken action to impose an additional liability on the taxpayer." As for paragraph (b) the amount of tax payable on the hypothetical basis that the return was correct was lower and it has in fact been paid.

Submissions on section 95 TMA

103. Turning from the provisions of section 95 to the amounts involved, the taxpayer cannot dispute that the amount of £122,731.77 was due from him to HMRC. He agreed to pay that amount to HMRC in accordance with the terms of the settlement agreement resulting from HMRC's acceptance of the taxpayer's Part 36 offer in tax recovery proceedings. The amount payable was described in the offer as "the aggregate amount of income tax assessable on the partners of the Appellant in consequence of the decision of the Special Commissioners" plus interest at the statutory rates on that sum. The result was the agreed sum of £122,731.77 which has been paid. The amendments to the relevant returns were withdrawn.
104. HMRC treated that agreed amount as item (i) in paragraph [101] above and calculated the difference between it and the amount of item (ii). They then issued a penalty notice in which the amount of the penalty did not exceed the amount in item (iii) in that paragraph. The penalty was fixed at 70% of the tax due and in the amount of £53,555.
105. The taxpayer contends that it is wrong to treat £122,731.77 as the amount of item (i) because it was due to HMRC as a contractual debt and not an amount of tax payable. It would follow that the amount of that item *as tax* is nil; that the difference between items (i) and (ii) is nil; and that, as the amount of the penalty cannot exceed that amount, HMRC cannot exercise their statutory power to impose a penalty on the taxpayer. Although the taxpayer is liable to a penalty in principle, he cannot in practice be made liable to any penalty.
106. My first reaction to this submission was that, as it is sometimes pompously put in these courts, the outcome is "counter-intuitive", or, as Bingham LJ said more elegantly in *Nuttall*, it is "offensive to good sense." Some people (outside the

common courtesies of the court room) might say that it is bonkers. Whatever reaction is provoked by the submission, it is said to be soundly based on the decision of this court in *Woollen* on the legal consequences of settlement agreements between taxpayers and HMRC.

107. The taxpayer says that section 95(2)(a) requires the amount specified to be tax payable for the relevant years under a subsisting assessment; that in this case there is no subsisting assessment, as the amendments to the partnership tax returns were withdrawn with the agreement of HMRC and the returns were not amended by the taxpayer; that the amount the taxpayer agreed to pay in the Part 36 offer became payable to HMRC as a contractual debt, not as tax or as interest on tax; that the agreement between him and HMRC could not have made the amount payable as tax; that the agreement does not purport to express the amount payable as tax or as interest on tax, or treat the amount payable as if it were tax; that the amount of £122,731.77 cannot therefore be brought into account under section 95(2)(a); that the amount for the purposes of section 95(2)(a) is the same as the amount specified in section 95(2)(b); and that, there being no difference between the two amounts, the maximum penalty is nil. QED!

Discussion and conclusion

108. Lloyd LJ comments that it is evident that that is not what HMRC expected or intended. I agree. He also indicates that HMRC could in future avoid this argument by insisting on express provision for a penalty in the settlement agreement and for preservation of the power to issue penalties by maintenance of the necessary assessments. I agree.
109. However, I find it impossible to travel with him any further than that. I do not, with great respect, agree with his construction and application of section 95(2)(a).
110. Point 1, it is improbable that Parliament, when enacting section 95(2)(a), could have expected, let alone intended, to produce the result for which the taxpayer contends. I repeat that the purpose of the provision, subject to a cap, is to empower HMRC to penalise tax offenders, not to produce a situation in which HMRC are precluded from imposing any penalty on a tax offender.
111. Point 2, the language of the section, standing on its own, does not compel the court to accept the taxpayer's construction. Nothing is expressly said in section 95(2)(a) about the amount of tax being payable "as a result of an assessment for the relevant years" or similar wording.
112. Point 3 and most importantly, I disagree with Lloyd LJ about the impact of the decision of this court in *Woollen* on the construction of section 95(2)(a). He concludes (paragraph [66]) that neither the Special Commissioner nor Sir John Lindsay allowed to the decision of the Court of Appeal in *Woollen* the full significance that it has. He accepts the taxpayer's argument that, as *Woollen* shows that amounts due to HMRC under a settlement agreement are due and payable as a contractual debt, not as tax, the amount of £122,731.77 does not meet the requirements of section 95(2)(a).

113. That construction wrongly concentrates on the common law forms of action (contractual debt) and the statutory mechanisms for the recovery of tax from the taxpayer to the exclusion of (a) the different context of the penalty provisions and (b) the substance of this consensual tax transaction between the taxpayer and HMRC, as informed by the relevant surrounding circumstances. In my judgment, *Woollen* does not bind this court to accept the construction of section 95(2)(a) advanced by the taxpayer.
114. As for context, I agree with Sir Mark Waller that the fact that the compromise creates a contractual debt and that there are no amended returns is irrelevant in the context of section 95(2), which is solely concerned with the process of calculating the ceiling on the amount of the penalty that can be imposed on the taxpayer. It is not concerned with recovery of tax, or with proof of tax as a preferential debt, or with a defence to an action by HMRC for recovery under a settlement agreement.
115. As for substance, the amount of £122,731.77 fits the description of the amount referred to in section 95(2)(a). It was agreed upon as being the aggregate amount of tax and statutory interest due from the taxpayer and payable by him for the relevant years of assessment. That is the only available explanation for the Part 36 offer, its acceptance, the calculation of the amount and the payment of it. Having entered into such an agreement the taxpayer was bound by it and could not dispute the amount of tax payable by him. Though the cause of action for its recovery was now founded in contract, the only explanation for that amount is that it was agreed to be the amount of tax payable by the taxpayer. In the context of fixing the ceiling on a penalty under section 95(1) that amount is the first step in that process. The nature of the cause of action for recovering the tax has nothing to do with that exercise in calculation.
116. A little more on *Woollen* is necessary, as that case is central to the taxpayer's argument that the larger amount under section 95(2)(a) was not due from the individual taxpayer to HMRC by way of tax but as a contractual liability on the partnership. I rely on the following factors for the conclusion that it has no bearing on the construction of provisions enacted for the purpose of calculating the ceiling on the amount of penalty for tax offences.
117. First, as is obvious, though I agree not conclusive, the court in *Woollen* was not construing section 95, or any provision relating to the power to impose penalties, or their calculation. It is not a direct authority on the construction of the provisions relied on in this case
118. Secondly, *Woollen* was a private law action by HMRC on a settlement agreement made with a company director. He guaranteed payment of the relevant tax liabilities of his companies. They went into administrative receivership without HMRC claiming as preferential creditor for the sums owing from the companies. The court accepted that the revenue practice of settlement agreements was valid, as had been held by this court in *Nuttall*. Not surprisingly the court rejected the director/guarantor's defence that he was discharged from his guarantee, because HMRC had been entitled to claim as preferential creditors of the companies and had failed to do so. The basis for rejecting the defence was that the sums due under the agreement were a contractual debt and were not due as assessed income tax, so that HMRC had no power to rank preferentially as creditors for those sums due by the companies. The sums did not retain their identity as tax: they had lost that identity on becoming part of

an agreed global sum, which was not by itself assessed income tax and was collected as a debt due under the compromise contract. It was in place of tax originating from an assessment under statute and collected under statute.

119. I would not for a moment doubt the correctness of any part of the decision in *Woollen* that a sum due from the taxpayer under a settlement agreement with HMRC does not qualify as a preferential payment in the administrative receivership because it is not a claim for payment of tax. What I do not think is legitimate is to read that decision on the character of a contractual claim for payment in the context of proof for a preferential payment across to the quite different context of ascertaining, for the purposes of a cap on the amount of a penalty on the taxpayer, the amount of tax payable by a taxpayer, who has entered into a settlement agreement binding him to pay to HMRC an agreed amount in respect of the tax claimed plus interest.
120. For those reasons I disagree with Lloyd LJ and would dismiss the appeal. I agree with Sir Mark Waller and Sir John Lindsay that there was no error of law in the decision of the Special Commissioner. HMRC have power to raise a penalty determination under section 95, as they purported to do.