TC02549

Appeal number: TC/2012/06158

INCOME TAX – penalty for careless inaccuracy in self-assessment tax return under schedule 24 Finance Act 2007 – carelessness admitted – suspension of penalty – HMRC declined to suspend because of general policy not to suspend penalties for one-off errors – HMRC also did not address suspension condition suggested by Appellant – proposal that Appellant's self assessment tax returns during next two years be submitted on his behalf by suitably qualified professional adviser – whether HMRC's decision was flawed – held yes – appeal allowed and order made for HMRC to suspend penalty – no jurisdiction at this stage to lay down terms of suspension, but indication given as to terms considered appropriate

FIRST-TIER TRIBUNAL
TAX CHAMBER

DAVID TESTA **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: **JUDGE KEVIN POOLE**
CAROL DEBELL

Sitting in public at 45 Bedford Square, London on 10 January 2013

Neil Awbery of Clearsky Accounting for the Appellant

Christine Cowan, Presenting Officer of HMRC for the Respondents

DECISION

Introduction

1. This decision is concerned with an appeal against HMRC's refusal to suspend a penalty imposed under paragraph 1 of Schedule 24 to Finance Act 2007 for an admittedly careless inaccuracy in the Appellant's self-assessment tax return for the year ended 5 April 2010.

The facts

2. The Appellant was employed as Chief Executive Officer of Gatehouse Bank PLC (whose name was changed from Gatehouse Capital PLC on 16 April 2008).

3. In the absence of any statement to the contrary by HMRC, we accept the Appellant's assertion that his historical tax compliance record was good.

4. The Appellant's employment with Gatehouse was terminated with effect from 31 August 2009. We were provided with a single page extract from a Severance Agreement governing the terms of his departure. Pursuant to that agreement, the Appellant was to be paid a severance payment of £213,600.25, of which £100,000 was to be a payment in lieu of notice and the balance was to be compensation for loss of office. We were not informed of the date of the Severance Agreement, but it was early in September 2009.

5. The Appellant was issued with his P45 (showing salary received and tax deducted to date up to 2 September 2009) on 4 September 2009. Shortly afterwards, he received his severance payment. He also received a further payslip from Gatehouse showing the payment to him of the severance payment plus a small amount of basic pay and accrued holiday pay, less tax. Because this payment was made after he had left employment and been issued with his P45, tax was deducted from the total payment (apart from £30,000, which was treated as tax-free compensation for loss of office) at the basic rate of 20%.

6. The Appellant filed this last payslip with his other Gatehouse papers and kept the P45 with his tax papers for the purpose of filling out his year end tax return (similar to his previous practice of keeping and using his form P60 for the same purpose). He subsequently filled in his tax return using the figures from his P45 alone. He acknowledges this was a careless error. The effect of this was to leave out of his tax return the severance payment and the tax deducted at source from it.

7. In due course when HMRC cross checked his tax return against the employer's annual return from Gatehouse, they established the discrepancy and wrote to the Appellant on 27 January 2012 challenging him about it. The Appellant immediately acknowledged his error and provided a full explanation of how it arose. It is common ground that as a result of it he underdeclared income tax of £38,866.07 on his self-assessment tax return for 2009-10, and (although the Appellant initially disputed it) that this was a careless error in his return.

8. HMRC accepted the Appellant's explanation of how the error had arisen and in view of the Appellant's co-operation they mitigated the penalty down to the minimum provided for in schedule 24, namely 15% of the underdeclaration, i.e. £5,829.91.

9. On 1 March 2012 HMRC wrote to the Appellant, seeking to reach a final settlement agreement with him and informing him of the penalty which HMRC intended to charge. Attached as a schedule to that letter was a "Penalty Explanation". Included at the end of that schedule was the following text:

> "**Information about suspending penalties**
>
> We can only suspend a penalty that relates to a careless inaccuracy in a return or document. We can only suspend it if we can set conditions to help avoid penalties in the future and if we think the conditions can be met. We can suspend a penalty for up to 24 months.
>
> We cannot suspend any of this penalty. There are no specific, time bound, measurable conditions that can be set to help you avoid careless inaccuracies in the future.. Suspended penalties are explained in more detail in the factsheet CC/FS10 *Suspending penalties for careless errors in returns or documents*. You can get a copy of this factsheet from our website at **hmrc.gov.uk/compliance/factsheets** or, if you prefer, you can phone us and we will send you what you need."

10. On 12 March 2012 the Appellant sent an email to HMRC, in which the following paragraph was included:

> "In addition, I also believe that HMRC has grounds for imposing a suspended penalty, on the condition that if I always retain a tax adviser (as with ClearSky currently) there are "specific, time bound, measurable conditions that can be set to help [me] avoid careless inaccuracies in the future'."

11. HMRC replied by letter dated 19 March 2012. That letter included the following paragraphs which addressed the question of suspension of the penalty:

> "The termination payment was a "one off" which will probably not occur again in the near future. Had you omitted from your return, investment income for example, HMRC could put conditions in place to ensure careless inaccuracies are avoided in the future as you would receive interest annually as long as the account remained open. Clearly you would not expect to receive redundancy payments yearly.
>
> You were provided with all the paperwork to enable you to complete your return correctly. The omission arose because you erroneously did not file your payslip with the information you needed to complete your return. In view of the above no conditions that HMRC can set would prevent the error occurring in the future therefore HMRC are unable to suspend the penalty in this instance."

12. In reply, in an email dated 20 April 2012 the Appellant included the following text:

> "On the penalty, however, I maintain the view that the decision not to suspend the penalty is overly harsh, as there is an obvious condition which could apply to prevent further carelessness in the future, i.e. that I maintain ClearSky as my tax advisors to ensure future negligence does not occur.
>
> For that reason, please could I ask you to submit a formal notice of the decision not to suspend the penalty, as I will then formally appeal against this."

13. HMRC replied to this email by letter dated 9 May 2012, in which the formal penalty assessment was issued and the following paragraph was included on the topic of their refusal to suspend the penalty:

> "The information held has been reviewed and the view of the Inspector is that the penalty can not be suspended on the basis that suspension is not appropriate as the error was a 'one off' and conditions cannot be set. As I have stated in my previous correspondence, as you were provided with all the paperwork to enable you to correctly complete your return, no conditions that HMRC can set would prevent the error occurring in future therefore HMRC are unable to suspend the penalty in this instance."

14. The Appellant appeals against HMRC's refusal to suspend the penalty.

The law

Schedule 24 Finance Act 2007

15. Paragraph 14 of Schedule 24 Finance Act 2007 ("FA07") provides as follows:

> "**14 –**
>
> (1) HMRC may suspend all or part of a penalty for a careless inaccuracy under paragraph 1 by notice in writing to P.
>
> (2) A notice must specify –
>
> (a) what part of the penalty is to be suspended,
>
> (b) a period of suspension not exceeding two years, and
>
> (c) conditions of suspension to be complied with by P.
>
> (3) HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy.
>
> (4) A condition of suspension may specify –

(a) action to be taken, and

(b) a period within which it must be taken.

(5) On the expiry of the period of suspension –

(a) if P satisfies HMRC that the conditions of suspension have been complied with, the suspended penalty or part is cancelled, and

(b) otherwise, the suspended penalty or part becomes payable.

(6) If, during the period of suspension of all or part of a penalty under paragraph 1, P becomes liable for another penalty under that paragraph, the suspended penalty or part becomes payable."

16. Paragraph 15(3) of Schedule 24 to FA07 provides that "[a] person may appeal against a decision of HMRC not to suspend a penalty payable by the person" and paragraph 15(4) provides that "[a] person may appeal against a decision of HMRC setting conditions of suspension of a penalty payable by the person."

17. Paragraph 17 of Schedule 24 FA07, so far as relevant to appeals relating to suspension of penalties, provides as follows:

"**17 –**

….

(4) On an appeal under paragraph 15(3) –

(a) the tribunal may order HMRC to suspend the penalty only if it thinks that HMRC's decision not to suspend was flawed, and

(b) if the tribunal orders HMRC to suspend the penalty –

(i) P may appeal against a provision of the notice of suspension, and

(ii) the tribunal may order HMRC to amend the notice.

(5) On an appeal under paragraph 15(4) the tribunal –

(a) may affirm the conditions of suspension, or

(b) may vary the conditions of suspension, but only if the tribunal thinks that HMRC's decision in respect of the conditions was flawed.

….

> (6) In sub-paragraphs… (4)(a) and (5)(b) "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review."

Cases referred to by HMRC

18. Mrs Carwardine referred us to two cases, both of which were decisions of the First-tier Tribunal and are therefore not binding on us. The first was *Fane v HMRC* [2011] UKFTT 210 (TC) and the second was *Hearn v HMRC* [2013] UKFTT 782 (TC).

19. In *Hearn*, the background facts were similar to the present appeal. The appellant there had received a large severance payment from Lehman Brothers but had not included it at all in his tax return. The Tribunal in that case however found at [10] that "[w]e are entirely satisfied that the appellant chose not to disclose it. He took a gamble; he lost." This appears to suggest that the Tribunal found the inaccuracy to be deliberate (which would preclude any possibility of suspension in any event); however the Tribunal went on to consider briefly the question of suspension, and said this at [13]:

> "The appellant has also contended that the penalty should be suspended. In *Fane v HMRC [TC/2010/08765]* this Tribunal decided that the respondent was correct not to suspend a penalty unless the circumstances were such that suspension would or could lead to the non-repetition of the error or omission leading to the imposition of the penalty. That does not arise in this case. This was a one off omission from the tax return, which, at the very least, was careless or negligent."

20. In *Fane*, there were again similarities to the present case. A severance payment had been made to an employee of BNP Paribas. His last payslip included a deduction in respect of an advance that had been made by BNPP to him a few months earlier to fund a PAYE payment that arose because of a stock payment. The appellant mistakenly took this to be an actual PAYE deduction from his last payment of salary, and in due course returned it as such in his self-assessment return.

21. In due course, Mr Fane appealed both against the imposition of a penalty for this omission, and HMRC's refusal to suspend the penalty.

22. The Tribunal found the omission to have been careless and upheld the penalty. The more significant aspect of the decision was its discussion of the question of suspension.

23. It appears that Mr Fane had rental income, which was still continuing in the years after the year for which he had incurred the penalty. It was suggested by Mr Fane's representative (apparently at the hearing of the appeal) that the penalty could be suspended on condition that Mr Fane correctly returned his rental income in his self-assessment returns over the following two years. HMRC on the other hand cited their internal guidance:

> "I decided that the overriding factor was…. that conditions needed to be set that, if met, over a set period would help Mr Fane avoid an inaccuracy in his return arising due to similar circumstances as those occurring in his 2008-09 tax return. My decision included the opinion that there could be no realistic expectation of problems arising in payments relating to a termination of employment, in other words it was a "one-off event", consequently as future conditions can not be set the penalty can not be suspended."

24. The Tribunal was clearly not impressed with the suggestion that the penalty should be suspended. They focused on the particular objection raised by HMRC, to the effect that suspension was not applicable to "one-off events" such as this. They went on to say (at [60] to [67]):

> 60. On the face of the wording of paragraph 14 (3) there is no restriction in respect of a "one-off event". Nonetheless, it is clear from the statutory context that a condition of suspension must be more than an obligation to avoid making further returns containing careless inaccuracies over the period of suspension (two years). Paragraph 14 (6) provides:
>
> > "If, during the period of suspension of all part of a penalty under paragraph 1, [the taxpayer] becomes liable for another penalty and that paragraph, the suspended penalty or part becomes payable."
>
> 61. If the condition of suspension was simply that, for example, the taxpayer must file tax returns for a period of two years free from material careless inaccuracies, paragraph 14 (6) would be redundant.
>
> 62. Moreover, it is difficult to see how a taxpayer could satisfy HMRC that the condition of suspension, if it contained no requirement other than a condition not to submit careless inaccuracies in future tax returns, had been satisfied as required by paragraph 14 (6). This would, effectively, require the taxpayer to prove a negative will require *[sic]* HMRC to conduct a detailed review of the taxpayer's tax returns.
>
> 63. For these reasons we do not agree with Mr Lever's suggestion that a suitable condition of suspension would be a requirement that the Appellant correctly returned other income (e.g. rental income) on his tax return for the next two years.
>
> 64. A condition of suspension, therefore, must contain something more than just a basic requirement that tax returns should be free from careless inaccuracies. This suggests, therefore, that the condition of suspension must contain a more practical and measurable condition (e.g. improvement to systems) which would help the taxpayer to achieve the statutory objective i.e. the tax returns should be free from errors caused by a failure to exercise reasonable care.

> 65. Bearing these considerations in mind, HMRC's guidance indicating that a one-off error would not normally be suitable for a suspended penalty is understandable and, in our view, justified.
>
> 66. We are fortified in this view by reference to the Explanatory Notes published together with the Finance Bill 2007 in respect of the provisions which were eventually enacted as Schedule 24 Finance Act 2007. The relevant extract from the Explanatory Notes reads as follows:
>
> > " Suspended penalties will not be appropriate for one off inaccuracies in returns such as a capital gain or a one off transaction. They are more likely to be appropriate for accounting system or record keeping weaknesses, where the money that may have been spent on the penalty could be used to remedy the defective processes ensuring future returns are accurate."
>
> 67. For these reasons, we consider that Mr Woodroff did not mis-direct himself when deciding that he could not suspend the penalty in this case."

25. We respectfully agree fully with the comments made in paragraphs [60] to [64] above. As to paragraph [65] however, we feel that as a general statement it must be treated with care. It was made in the context of the particular condition suggested by the appellant in that case, which amounted (in the Tribunal's view) to little more than "a condition not to submit careless inaccuracies in future tax returns". There is no indication that any suggestion was made to the Tribunal in *Fane* along the lines of the condition that is being proposed in this appeal.

Case referred to by the Appellant

26. Mr Awbery referred us to another case, which was also a First-tier Tribunal case and therefore not binding on us: *Philip Boughey v HMRC* [2012] UKFTT 398 (TC). In that case, which again arose out of an admittedly careless inaccuracy in a self-assessment tax return arising from a severance payment, HMRC again refused suspension on the grounds that "… I need to set a condition that is specific to the careless inaccuracy – in your case, claiming the relief of £30,000 for redundancy payment in error. Under the circumstances, I do not see that a specific condition can be set to enable you to show that you are able to correctly declare a redundancy payment and claim the correct reliefs against any such payments."

27. The Tribunal in *Boughey* considered the decision in *Fane* and agreed that, to be valid, a condition of suspension should be "more than an obligation to avoid making further careless mistakes during the period of suspension." It then went on point out that there is nothing in the legislation that requires any condition to be "specific to the careless inaccuracy" and since HMRC had explicitly based their refusal on the fact that they could "not see that a specific condition can be set to enable you to show that you are able to correctly declare a redundancy payment and claim the correct reliefs against any such payments", that refusal must be flawed.

28. In *Boughey*, it is clear that the appellant had at some stage suggested a suspension condition which was different from that referred to in *Fane* (but similar to the condition proposed in the present case). At [16], the Tribunal said:

> "The appellant has proposed a condition to apply during any period of suspension being that during that period his tax returns should be prepared by a qualified accountant. That is not a generic condition but it is a condition that would be designed to or would assist in the submitting of accurate returns, so as to avoid any penalty arising based upon any of the various possible defaults set out in paragraph 1 of Schedule 24."

Discussion and conclusion

29. Schedule 24 FA07 sets out a new regime for suspension of penalties, for which there is no relevant precedent. The caselaw on it could best be described as "nascent".

30. The wording of paragraph 14(3) is clear in only authorising suspensive conditions where compliance with them "would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy."

31. The apparent underlying purpose of the legislation is not simply to allow a taxpayer the opportunity of "a last chance" if he mends his ways (akin to a suspended sentence in the criminal sphere) but only to allow him that last chance if he takes some specific and observable action which is specifically designed to improve his compliance.

32. Although the legislation does not specify the nature or extent of the required linkage between the earlier default and the action required by the suspensive condition, the use of the word "further" in paragraph 14(3) seems to us to imply that there must be some such linkage.

33. It therefore seems unlikely that paragraph 14(3) is intended to cover a situation where, for example, a taxpayer carelessly gives inaccurate information in a Construction Industry Scheme return and then seeks to have the penalty suspended on the basis of a promised improvement in his PAYE record keeping processes.

34. On the other hand, consider a case in which the original inaccuracy had arisen, say, because of a particular weakness in the taxpayer's system for distinguishing between CIS payments for materials and construction services in certain unique circumstances. Let us assume the taxpayer, alarmed by the problem, had instructed an external professional firm to carry out a full review of its whole CIS reporting process and obtained a report giving recommendations for its improvement (including the elimination of the weakness that gave rise to the particular error, even though it was unlikely to recur). If the taxpayer offered to agree a condition requiring it to implement those recommendations, that would surely meet the underlying purpose of the legislation and fall within paragraph 14(3), even if the circumstances giving rise to the particular error were a "one off" and unlikely ever to be repeated.

35. HMRC's policy (as referred to in their letters referred to at [11] and [13] above) sits uneasily with the above example. If their stance were correct that "one-off" inaccuracies (or inaccuracies arising from "one off" events) could never benefit from the suspension regime, then they would refuse to allow the suspension. This must in our view be wrong. Instead in such a case they should simply consider whether the implementation of the external report would help the taxpayer to avoid future inaccuracies in its CIS returns.

36. This example highlights the danger of taking too narrow a view of the legislation. It has been drafted deliberately broadly and HMRC should not be placing unwarranted limits on it by reference to general policies which exclude whole classes of case which, in our view, would have been intended to be covered by it.

37. In the present case, the Appellant has suggested the imposition of a suspensive condition to the effect that his self-assessment tax returns for the next two years should be submitted on his behalf by an appropriate professional adviser. He says, quite rightly in our view, that compliance with such a condition would help him to avoid becoming liable to further "careless inaccuracy" penalties in relation to his self-assessment tax returns. Such a suggestion having been put to HMRC, it seems to us that it should be considered on its merits in accordance with the terms of the legislation by reference to whether or not it will help the Appellant to avoid future careless inaccuracies in his self-assessment tax returns; it should not be simply ignored or discarded as a result of a policy which says that "there can be no suspension of penalties for one-off errors".

38. In this case, however, HMRC have treated the Appellant's suggestion in precisely that way. Although the suggestion was put to them twice, they did not give any indication as to why they considered it did not meet the requirements of the legislation, beyond their blanket statement that "one-offs" were not appropriate for the suspension regime. Not only have they taken into account matters that they should not have taken into account (in simply following their general policy of "no suspension for one-offs"), there is also no evidence (which could have been provided by, for example, a reasoned discussion and rejection) that they gave any proper consideration to the suggestion actually made by the Appellant.

39. As a result we find that HMRC have acted in a way which is flawed for the purposes of paragraph 17(6) of Schedule 24 FA07.

40. The consequence of that finding is that under paragraph 17(4)(a) of Schedule 24 FA07, we are empowered (but not required) to order HMRC to suspend the penalty. We should clearly only do so if we consider that such suspension would, in all the circumstances, be appropriate.

41. In this case, given the Appellant's past compliance record, the circumstances of this particular error and the condition actually proposed by the Appellant (which was refined at the hearing to include a requirement for a suitably qualified professional to certify, when submitting the Appellant's self-assessment tax returns over the next two years, that such returns are accurate to the best knowledge and

belief of that qualified professional), we consider it is appropriate to order HMRC to suspend the penalty.

42. The appeal is therefore allowed and we order HMRC to suspend the penalty. The way paragraph 17 of Schedule 24 FA07 works means that we have no jurisdiction to make any order at this stage as to the precise terms of the condition(s) that should apply to the suspension. If the detailed terms of the suspensive condition(s) cannot be agreed, then the Appellant will have a further right of appeal to the Tribunal under paragraph 17(4)(b) Schedule 24 FA07, but we hope that by giving the above indications we will have forestalled the need for any such further appeal. For the avoidance of doubt, we would anticipate that "suitably qualified" individuals for the purposes of the relevant condition would include at least those holding the ACA, ACCA and CTA qualifications.

43. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 18 February 2013