

# Pro-holy and pro-Fane

Management of taxes

Personal tax



01 November 2016

*Keith Gordon* considers a recent Tribunal decision concerning the potential suspension of penalties

## Key Points

## **What is the issue?**

Mr Eastman failed to disclose a capital gain on his tax return. HMRC held that they were unable to suspend any penalty because it was a one-off transaction.

## **What does it mean to me?**

The Tribunal found in favour of the taxpayer, concluding that the 'acid test' was to ascertain what went wrong originally so as to identify whether the taxpayer would do something differently.

## **What can I take away?**

Suspension decisions should now be made using the Tribunal's clear guidance in this case and not the case of *Fane*.

One of the novelties of the penalty provisions found in FA 2007, Sch 24 (penalties for inaccurate tax returns etc) is the opportunity for some penalties to be suspended. As the Powers Review Team (which was responsible for the introduction of the legislation) was at pains to stress, the underlying ethos of the penalties code was to deter rather than to punish: indeed, it was often repeated that HMRC would rather that taxpayers got it right first time than paid penalties. I have every belief that that was the approach taken by the Powers Review Team. However, I am equally of the view that the teams that were responsible for the subsequent roll-out of the rules had a very different approach, possibly as a consequence of the economic difficulties that the country had found itself in by the time that the rules came into force.

As a result, the power to suspend penalties has been used less often than it could. Furthermore, HMRC have regularly defended decisions not to suspend penalty at the First-tier Tribunal for what I believe are often spurious reasons.

The first major decision on the subject of suspensions was *Fane v HMRC* [2011] UKFTT 210 (TC). This has widely been taken by HMRC as authority for the proposition that suspension is not available to avoid penalties arising as a result of one-off errors. Even as recently as mid-2015, the Tribunal (after citing *Fane*) concluded that suspension was not appropriate in a case where a taxpayer had

carelessly omitted a new source of income, as the newness of the source meant that the error was one-off (*Havercroft v HMRC* [2015] UKFTT 0389 (TC)).

The topic has returned to the Tribunal, however, in the case of *Eastman v HMRC* [2016] UKFTT 0527 (TC).

## **The facts of the case**

The case appears pretty typical of many involving penalties. The taxpayer (Mr Eastman) omitted a capital gain from his 2012/13 tax return. The gain arose as a consequence of the disposal by Mr Eastman of his business (which had been operated through a limited company) in the previous tax year. The disposal of the company shares was correctly entered on Mr Eastman's 2011/12 tax return, but the business premises (which had been held outside the company) were not disposed of until the following tax year. It was this disposal which failed to make its way onto Mr Eastman's tax return.

Although not necessarily relevant to the case, I shall note for completeness that Mr Eastman had been personally responsible for the negotiations which led to the sale of the company shares but it was his co-director and co-shareholder who negotiated the disposal of the premises.

Mr Eastman's tax return was usually prepared by one partner of a firm of accountants who duly made a file note of the capital gains computation relating to the sale of the premises. However, the 2012/13 return was prepared by a different partner who, according to the decision 'had not previously completed Mr Eastman's returns [and who] failed to check the file to discover the details of the sale and the CGT computation'. Mr Eastman did not spot the omission 'despite having checked the return'.

An enquiry was opened into Mr Eastman's 2012/13 tax return on 20 January 2015. Despite that coming in the middle of what is most firms' extremely busy season, the accountants acknowledged their error by 28 January 2015 and the additional tax was paid by Mr Eastman on 13 February 2015. Then HMRC started to ask for a penalty.

HMRC's opening gambit was that the omission had been deliberate. Following a meeting, however, HMRC were persuaded to drop that particular line and asserted

instead that the omission had been careless. HMRC claimed to have considered suspension (presumably because they are required to do so) but concluded that 'no suspension conditions can be put in place'. As a result, Mr Eastman faced a penalty amounting to over £21,000.

The accountants conceded that the omission had been careless but pressed for suspension. They suggested that Mr Eastman maintain a weekly diary to record all financial events which would then be provided to the accountants when preparing his tax return and would also be available for Mr Eastman when checking his return. This approach was rejected by HMRC for the following reason: 'Mr Eastman sold his business premises and omitted the capital gain on the sale of the premises from his 2013 return ... Mr Eastman no longer has any businesses/business premises that, if sold, would lead to a capital gain. As there is no longer any likelihood of a future capital gain, there is no condition that can be set to avoid an inaccuracy arising in future. So in my opinion we cannot suspend the penalty.'

The subsequent internal review process led to a similar conclusion: 'Suspended penalties will not be appropriate for one-off inaccuracies in returns such as a capital gain or a one-off transaction'.

## **The Tribunal's decision**

The Tribunal (Judge Roger Berner sitting with Mr John Robinson) considered the framework of the legislation concerning the suspension of penalties. It noted that the decision whether or not to suspend a penalty is at HMRC's discretion. Nevertheless, as the Tribunal continued, such discretion must be exercised reasonably and within the framework of the legislation.

Within the legislation, there is only one specific limitation on the exercise of the discretion to suspend a penalty. This is in the Finance Act 2007, Schedule 24, paragraph 14(3) which provides that suspension may occur only if compliance with a condition of suspension would help the person liable to the penalty to avoid becoming liable to further penalties for careless inaccuracies.

Although the Tribunal correctly noted that the public law principle of fairness encourages public bodies such as HMRC to provide guidance to officers, the Tribunal also correctly noted that such guidance 'should go no further than is required to ensure consistency of approach' and that it 'should not fetter the discretion of an

HMRC officer' (except, of course, so far as any fetter is consistent with the legislation itself).

Mr Eastman's representative had referred to further HMRC guidance (in CH405050) which appeared to dilute some of HMRC's previous opposition to the suspension of penalties following one-off errors. That had been referred to in a report by the Office of Tax Simplification which noted that HMRC had failed to convey the message more widely to its front-line staff. However, as the Tribunal noted, even the wording in CH405050 appeared to fetter HMRC's discretion as it still put too much focus on the nature of the original error. Indeed, as the Tribunal held (quite correctly, in my view): 'All that para 14(3) requires is that the condition or conditions would help the taxpayer avoid further penalties for careless inaccuracy. There is no necessary link between the type of inaccuracy and the possibility of future penalty.'

It noted, however, that the nature of the original error should not be totally irrelevant – it is part of the process by which the officer should exercise his or her discretion.

In the course of her submissions before the Tribunal, the HMRC presenting officer had argued that it is not enough for the suspension conditions to help meet an existing statutory obligation to submit accurate tax returns. However, the Tribunal considered that that was 'precisely what a suspensive condition must do'.

The Tribunal considered that 'the acid test' was to ascertain what went wrong originally so as to identify whether the taxpayer could have done something differently, which would have avoided that earlier inaccuracy.

In summary, the Tribunal recognised that HMRC's decision to refuse to suspend the penalty was flawed as it put too much focus on the nature of the original inaccuracy (rather than the reason for it). Furthermore, the Tribunal directed that HMRC suspend the penalty. However, the Tribunal declined to set the terms of any suspension and remitted that matter back to HMRC (with Mr Eastman having the right to appeal against any terms if so required).

## **Commentary**

The Tribunal did not have to consider the question of careless conduct, because the point had been conceded by the taxpayer (or on his behalf). However, although I

suspect that the Tribunal would probably have concluded that there had been carelessness by Mr Eastman, the point is not beyond doubt. After all, penalties (unlike discovery assessments) turn on the conduct of the taxpayer personally – the fact that the accountants in this case seem to have clearly been careless, that should not be relevant. In the present case, what was there to prompt Mr Eastman to the fact that his tax return should have reported a capital gain? The event took place more than a year before Mr Eastman prepared his tax return and was connected with the business disposal which had taken place in the previous tax year (and which had been correctly reported). Furthermore, Mr Eastman's tax return (as prepared on his behalf) would not have included the capital gains pages and therefore, when checking his return, Mr Eastman would have had no specific question to alert him to the fact that any entry was missing. In any event, given that his accountants had all the relevant information, there is an argument to suggest that Mr Eastman was perfectly entitled to trust them to get it right? How many lay clients can be expected not only to identify errors in what is reported but also to spot omissions from pages that are not even provided to them?

So far as suspension is concerned, it is hoped that the decision will end the heresy that the *Fane* decision tended to promote: that one-off errors cannot lead to a suspension of penalties. However, given the fact that *Fane* had been doubted by a number of Tribunal decisions in the interim, one has to question why HMRC officers are still being routinely instructed to rely on it. Is that failing deliberate or merely careless?

To be fair to the officer representing HMRC in the Eastman case she did highlight some of those later cases and expressed HMRC's view that those other decisions had been wrongly decided. There again, the officer suggested that HMRC's view was that the Tribunal (in those other cases) had 'adopted a rigid interpretation of para 14(3)'. This submission did not appear to have gone down too well with the Tribunal because, as the decision continues, 'when asked by the Tribunal to explain this submission, [the officer] withdrew it. We consider she was right to do so.' Indeed, the Tribunal went on to explain that HMRC's assertion was completely at odds with the Tribunal decisions which HMRC had attempted to denigrate. Again, the officer's approach does raise questions. Nevertheless, as I have said, I would like to think that taxpayers will in future not have to go through the experiences suffered by Mr Eastman and that, in future cases involving penalty suspension (whether they are at the early stages or being argued before a Tribunal), HMRC will be guided by what

the Tribunal has emphatically concluded in this case.

One issue that is worth noting is that the Tribunal seemed quite keen to suggest to HMRC that they depart from their existing policy and consider partial suspensions, as permitted by the statute. It remains to be seen whether this will be adopted.

There is also a procedural point which would not have affected the present case but could be significant in others. The Tribunal focused on the decision process which led to the penalty assessment being issued. In the cases of *Half Penny Accountants Ltd v HMRC* [2016] UKFTT 45 (TC) and *Archer v HMRC* [2016] UKFTT 141 (TC), however, the Tribunal proceeded on the basis that the decision which is the subject of the appeal to the Tribunal is in fact that reached at the internal review stage. There is merit to both approaches and, one day, I suspect that the position will be clarified.

In the meantime, I hope that questions regarding suspension will now be made in the light of the Tribunal's clear guidance so that there can be greater adherence to the legislative scheme and less reliance on *Fane*.