

# Tribunal penalties: suspension of disbelief

Personal tax

Management of taxes



18 November 2024

We consider the penalty consequences when a claim for entrepreneurs' relief was wrongly made, examining the tribunal's decision to impose penalties for carelessness and its narrow interpretation of suspension rules for one-off errors.

## Key Points

### What is the issue?

The case of *Cox v HMRC* involved a married couple who sold their shares in a company after reducing their shareholdings below the 5% threshold required for entrepreneurs' relief. They claimed the relief erroneously, and HMRC imposed penalties for careless conduct, refusing to suspend the penalties.

### What does it mean for me?

The First-tier Tribunal found the taxpayers careless for not seeking professional advice after being told they qualified for the relief and then changing their shareholdings. It also rejected the proposed suspension conditions, believing one-off errors were unsuitable for suspension and that a face-to-face meeting with their tax adviser would not help prevent future errors.

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

The error was an honest mistake, and the ability to rely on professionals should be considered when determining reasonable care. The tribunal's narrow interpretation of the suspension rules highlights the complexity of tax rules and the dangers of making assumptions about reliefs.

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In the June issue of *Tax Adviser*, I reported on the *Cooke* case ('Two DP or not two DP, that's the problem'), where an individual was able to secure a claim for entrepreneurs' relief, despite having a shareholding that was below the minimum 5% threshold. The facts of that case were, of course, exceptional.

In this article, I consider the more recent case of *Cox v HMRC* [2024] UKFTT 510 (TC), where again an entrepreneurs' relief claim was made despite the taxpayers' shareholdings falling below that threshold. The question for the tribunal on this occasion was whether, in addition to the additional capital gains tax payable, the taxpayers were required to pay HMRC a penalty under the rules in the Finance Act 2007 Sch 24 for wrongly claiming the relief.

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### **The facts of the case**

The appellants were a married couple who owned some of the shares in a trading company. Together with some of the other shareholders, in 2018 they decided to sell their shares to four other co-shareholders. The transaction was to be in cash.

At that time, the appellants each owned 6.4% of the shares in the company (and had at least 5% both of the voting rights and of the rights to the proceeds on any distribution on winding up).

In April 2019, a meeting was held with all the shareholders at which it was confirmed that each of the shareholders owned sufficient shares to be entitled to

entrepreneurs' relief (which was later renamed business asset disposal relief) and that all the other conditions for relief were met. In relation to two of the outgoing shareholders (not the appellants), it was noted that the entitlement to entrepreneurs' relief was less clear cut and they were advised to seek specialist advice.

The directors of the company (who were some of the shareholders) were concerned to ensure that the proceeds that they received from the sale appropriately recognised the contributions to the company made by each of the shareholders. To effect this, the parties agreed to redistribute some of the shares between themselves prior to the sale.

Accordingly, prior to the sale, the appellants gave some shares to other shareholders, taking each of their own shareholdings to approximately 4.1% of the company's overall ordinary share capital. The appellants were assured that these gifts would not give rise to any capital gains tax on the basis that the gifts would qualify for holdover relief and that there would be no inheritance consequences.

However, as readers will immediately appreciate, that step did preclude the appellants from being able to claim entrepreneurs' relief on the subsequent sale of the rest of their shareholdings. However, not realising this, the appellants claimed entrepreneurs' relief on their disposal of their remaining shares, which took place in May 2019.

This point was, however, not identified by any of the advisers who were acting in relation to the sale. (It could be argued that they were not contracted to advise the appellants on this aspect of the sale. The solicitor said: 'At first glance I do not see anything wrong with the proposal ... but I am not an out and out tax expert.')

Nor was it identified by the appellants' accountant, who had been advising the appellants and preparing their tax returns for many years 'reliably and accurately' when he prepared their 2019/20 tax returns the following year.

HMRC opened enquiries into the appellants' tax returns and promptly identified the error. They decided that the claim to entrepreneurs' relief amounted to a careless error and then refused to suspend the penalties imposed on each of the appellants. The reason for refusing to suspend was that the enquiry itself had taught the appellants the conditions for what is now business asset disposal relief, and therefore it would not be possible to identify conditions of suspension that would

help the appellants from making a similar error in the future.

The appellants appealed against the decision to impose the penalties for careless conduct and, in the alternative, against HMRC's refusal to suspend the penalties.

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## **The First-tier Tribunal's decision**

The case came before Judge Ruthven Gemmell and Ann Christian.

The tribunal considered that the appellants had been careless. It was not a sufficient defence that the appellants had sought professional advice when their tax returns were prepared. According to the tribunal, the carelessness was due to the appellants 'not taking professional advice after having been told that they qualify for entrepreneurs' relief and then changing their shareholdings... [T]hey completed their tax returns based on previous advice based on different facts.'

In relation to the suspension, the tribunal was taken to a range of conflicting decisions of the First-tier Tribunal. In particular, in an early case on suspension, *Fane v HMRC* [2011] UKFTT 201 (TC), the First-tier Tribunal stated that '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'. On the other hand, *Eastman v HMRC* [2016] UKFTT 572 (TC) was one of several cases in which the tribunal took the contrary view.

None of these cases was binding on the First-tier Tribunal, which in this instance decided that there were no possible suspension conditions that could satisfy the statutory requirement of helping the taxpayer to avoid becoming liable to further penalties for careless inaccuracy in a tax return.

A part of the tribunal's difficulty was its belief that one-off errors would not normally be suitable for suspension. Furthermore, the First-tier Tribunal rejected the suggested suspension conditions being that the appellants have a face-to-face meeting with their tax adviser each year, as this 'did little more than transfer what had been carried out electronically to a face-to-face meeting'.

In rejecting the appellants' proposal, the First-tier Tribunal noted that their adviser had accurately and competently completed their tax returns without requiring any face-to-face meeting and therefore that such a meeting was unlikely to have any

effect on the accuracy of future tax returns.

As a result, the First-tier Tribunal upheld HMRC's refusal to suspend the penalty.

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## Commentary

The appellants' error was clearly an honest and in many ways an understandable mistake. From the perspective of a non-tax specialist, it is not surprising that an individual told that his shares qualified for entrepreneurs' relief would not appreciate that that was contingent on maintaining a 5% shareholding up until the final sale of the shares. The appellants' assumption that all was in order is even less surprising when the company's solicitor said that he could not see anything wrong with the proposals, even if he said that he was not giving formal tax advice.

As tax practitioners, we are of course trained to spot these problems and our instinct is to tell lay taxpayers not to assume anything. However, is it reasonable to expect taxpayers to seek advice at every step – and to pay for it? (If you experience an ache or skin rash, for example, do you automatically seek medical attention or do you wait a while and, if the problem goes away, assume that it is nothing to be concerned about?)

Whether rightly or wrongly, there is a general assumption within the tribunals that making assumptions about tax that turn out to be incorrect amounts to a failure to take reasonable care and therefore exposes a taxpayer to potential penalties.

Nevertheless, let's proceed on the assumption that the appellants' decision to proceed with their share disposals, without double-checking that they would be entitled to claim entrepreneurs' relief, amounted to careless conduct.

That carelessness does not give rise to any penalty (besides a larger tax liability than might have been expected) because the statutory test for a penalty requires (in this case) the taxpayers to *claim* entrepreneurs' relief erroneously and carelessly. The erroneous claim was made when the taxpayers' returns were submitted (in 2020); and therefore the question is not whether the actions taken in 2019 amounted to carelessness but whether the subsequent submission of the tax returns with the entrepreneurs' relief claims was careless.

Here, it should be remembered, the appellants did take further advice and from an accountant who had served them well for two decades. In some ways, this fact disproves one aspect of the tribunal's reasoning: 'the carelessness was [the appellants] not taking professional advice'. It is somewhat unfortunate that their accountant did not spot that the April 2019 gift of shares took the resulting shareholding below the 5% threshold: unlike the position for the company's solicitors, this is surely something that the accountant should have spotted and should have been expected to check when the tax returns were prepared.

I fully accept that the appellants could have done more at various stages. But I do think that they did not act unreasonably (when looked at overall) and, in particular, they took reasonable care to ensure that their tax returns were correct by engaging a seemingly competent professional to assist them. This is not to suggest that every taxpayer who uses an adviser to prepare a return should escape a penalty if the tax return proves to be incorrect (and understates the taxpayer's liability). However, in my view, in such cases, HMRC should need to show why such a step was not sufficient to amount to taking reasonable care. Otherwise, the concept of an error arising despite taking reasonable care becomes increasingly illusory.

Indeed, the ability to be able to rely on professional advice would seem to reflect the statutory wording in Sch 24. Furthermore, it would also seem to satisfy the policy intention behind the rules, which is to encourage taxpayers to get their tax affairs right: such a policy would be best achieved if taxpayers were encouraged to seek appropriate advice (and, more importantly, not discouraged from taking such steps).

So far as suspension is concerned, it is my view that the tribunal has taken to heart much of HMRC's guidance, rather than focusing on the statutory language itself. All that the legislation requires is that conditions of suspension 'would help [the taxpayer] to avoid becoming liable to further penalties [under Sch 24 para 1] for careless inaccuracy'.

There is nothing that precludes a penalty being suspended simply because the error arose in relation to a one-off transaction. Indeed, the legislation fairly means that the steps should help the taxpayer to not make a careless error on a tax return; there is nothing that requires the conditions to be focused on preventing a similar type of error.

Even if taxpayers might occasionally err (unintentionally but due to a failure to take reasonable care), it should be assumed that once advised of their error, most are unlikely to repeat the error and won't require a whole set of 'suspension conditions' to achieve that aim.

The First-tier Tribunal thought that the suspension rules should not operate as a 'get out of jail free card'. However, I would ask, why not? In the case of a one-off error, the error arose simply because there was something that the taxpayer had overlooked when dealing with a one-off transaction. Why should the taxpayer in such a case not be permitted to take steps that will help the taxpayer avoid making careless errors of any kind in the future? Why should suspension be limited to more routine errors, particularly as such errors are likely to be less forgivable than ones arising from one-off transactions?

In the same vein, I also fail to understand why the use of a tax adviser, say, should not be an acceptable condition for suspension, even if that tax adviser has been used for several years already. After all, the legislation does not expressly require additional steps to be taken. The purpose of the suspension rules is to show that penalties are not to be used as a cash-generating measure but merely an incentive to future and ongoing compliance. That policy objective is not going to be achieved by restricting unduly the cases where a penalty may be suspended.

Indeed, it is worth remembering what the First-tier Tribunal said in *Fane*, the case heavily relied upon by HMRC in the present case to justify its refusal to accept suspension terms. Uncontroversially, the tribunal noted that the suspension conditions should be those that are likely to have the desired effect of avoiding carelessness penalties in future. In *Fane*, the tribunal then gave an illustration of a case where such an effect was unlikely - that 'the taxpayer in question has previously breached other conditions or has a record of repeated non-compliance'. The present case involved taxpayers at the opposite end of the spectrum where, with the help of their professional adviser, they had an unblemished compliance record. Ironically, that fact appears to have counted against them when they sought the suspension of their penalties.

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## **What to do next**

The most important lesson from this case is that tax is complicated and how dangerous it can be to make assumptions about whether a particular relief will be available. That said, it remains my view that the appellants were somewhat unlucky to be saddled with the penalties in this case as, at the very least, a suspension ought to have been available.

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