# TC01435

**Appeal number: TC2010/08979**

***Omission from tax return - penalty assessment under paragraph 17 Schedule 24 Finance Act 2007 - appeal against penalty - appeal against decision not to suspend penalty under paragraph 14 - was Appellant careless - yes - was decision not to suspend penalty flawed - no - were there special circumstances to take into account as envisaged by paragraph 11 - yes - were these considered - no - decision to reduce penalty as a consequence of special circumstances but appeal otherwise dismissed***

**FIRST-TIER TRIBUNAL**

**TAX**

**THOMAS HARDY** **Appellant**

**- and -**

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

**TRIBUNAL: MRS JUDITH POWELL (TRIBUNAL JUDGE)**
**MRS C S de ALBURQUERQUE (MEMBER)**

**Sitting in public at 45 Bedford Square, London WC1 on Tuesday 21 June 2011**

**Mr Nigel May Macintyre Hudson LLP for the Appellant who was also present and gave oral evidence.**

**Mrs Eleanor Gardiner HMRC Presenting Officer representing the Respondents and also present Mrs Jane Chaney Notetaker for HMRC and Mrs Jane Foster observer for HMRC.**

## DECISION

1. This is an appeal against(a) a Penalty Assessment for £31,971 made under Paragraph 17 Schedule 24 Finance Act 2007 on 27 July 2010; and(b) the Decision not to suspend the penalty under Paragraph 14 Schedule 24 Finance Act 2007

### Facts

2. We found the following facts from matters agreed between the parties, documents and correspondence provided to us and oral evidence from the Appellant:

3. The Appellant submitted his tax return for the year ending 5 April 2009 in October 2009. The latest date on which his return for that period could have been submitted on time was 31 January 2010. It was agreed that he had a previously impeccable record for filing tax returns and paying tax due.

4. In finalising his tax returns he had always followed the same procedure. He gave his accountant the formal paperwork he received from his employer (Forms P60 and P11D were the forms he normally received showing his salary and benefits) and the dividend vouchers and interest statements he received from those with whom he had investments. He adopted a similar procedure when sending her details for his 2008-09 return but for that year he provided her with a P45 rather than a P60 because his employment terminated during the year.

5. His employment terminated on 31 July 2008 when the Appellant was made redundant. The redundancy process had been started in June 2008 and came as a total surprise to the Appellant who had felt he was a relevant part of a successful department at the Royal Bank of Scotland. The Appellant was, until he left the Bank, Global Head of Projects and Export Finance and Head of the Middle East and Africa Division. His remuneration in the two previous years had been in excess of £1m and he had been sufficiently confident of the Bank to take up a rights issue offered by it with a cost to him of £250,000. The redundancy process was complex and as well as being personally involved in the negotiations he had legal advice. He does not recall having discussed tax with his lawyer. The complexities of the process related in some part to the method by which he would be compensated and whether there would be a contribution to a pension scheme for his benefit but most importantly to the Appellant involved the question of whether the Bank would give him a Bank indemnity because of the Appellant's potential involvement as a Bank employee in the litigation which involved the company Enron whose affairs had by then generated a great deal of complexity and litigation.

6. The Bank did agree to provide the Appellant with an indemnity but only on condition he agreed to be a witness in any litigation involving that company. . After his employment ceased there was litigation (not in the UK) and he was called upon to give evidence for which he underwent extensive witness training. The case in which he gave evidence is a matter of public record.

7. He found the redundancy process very stressful and this was complicated by pending litigation involving the Bank where he was concerned he might have personal liability. The Appellant also felt he was under financial pressure to find further

employment following his redundancy. He did find alternative employment as chairman with another company but he soon became concerned about the governance of that company and left that employment after a short period. He received a small voluntary payment from them but found it difficult to obtain formal paperwork from them. The combination of the sudden redundancy, the difficult negotiation about his terms of departure, the anticipation of semi retirement, the failure of the new employment and his involvement with the litigation meant that the Appellant was in a very anxious state during the latter part of 2008 and 2009.

8. In October and December 2008 and in accordance with the terms agreed with the Bank as part of the redundancy process the Appellant received a substantial cash payment from them - these payments amounted in total to over £1m from which the Bank deducted tax at the rate of 20%. He told us and we believed him that he had not received any specific paperwork from the Bank when they sent these payments to him and in particular he did not have details of tax deducted from them. He had signed a compromise agreement before leaving the employment and it is possible that taxation was mentioned. We were not shown a copy of the agreement or any correspondence about it and have had to conclude that it did not contain anything helpful to the appeal.

9. Neither of the payments made to the Appellant in October and December 2008 was declared on his tax return for the period ending 5 April 2009. He sent his accountant a copy of his P45 showing his salary to the date of departure and this was declared on his return. He did mention to his accountant that he had been made redundant but she did not enquire whether he had received any payments in connection with that. The return did not disclose that he had left his employment. He approved his return which was submitted electronically.

10. The Royal Bank of Scotland showed the amount of the October and December 2008 payments and the amount of tax deducted from them on their employer end of year return. On 12 April 2010 Mr Hardy's accountant received a letter from HMRC giving notice of their intention to check his 2008-09 return because the employment income shown on his annual self assessment tax return did not accord with the figures shown by his employer on their end of year return. The employer's return included not only the employment income shown on the P45 which Mr Hardy had given his accountant but also the October and December payments which were paid after his employment had terminated and which had been subject only to the basis rate of tax. The October and December 2008 payments were subject to tax at the higher rate and additional tax of £213,140 was due from Mr Hardy which he paid once he realised he had the outstanding liability. He did not receive clarity on the position until he eventually received a Statement of Income and Tax Deducted from his former employer on 12 May 2010.

11. Mr Hardy found it extremely difficult to obtain information from his former employer about the way in which the payments had been taxed for which he eventually received a written apology. There was some suggestion from the bank that they had sent out details when they made the 2008 payments but we were not convinced that the documents copied by the Bank as evidence of this had been sent to Mr Hardy. On eventual receipt of the Statement from the Bank on 12 May 2010 he forwarded it to HMRC on 17 May.

12. On 19 May 2010 the officer at HMRC dealing with the enquiry, a Mr Woodroff had a telephone call with Mr Hardy's accountant and in that call indicated he would consider the Appellant's behaviour and that a penalty of 15% of the tax underpaid was likely to be imposed. On 20 May 2010 Mr Woodroff wrote to the accountant indicating his intention to charge a penalty and based his decision on the Appellant's failure to obtain full documentation from his employer regarding his termination until prompted by the enquiry. He set out the way in which the penalty (which he set at 15%) had been calculated and that it was based on his view that the Appellant was careless "on the facts before him". He indicated that the quality of the behaviour could reduce the penalty from 30% to 15% and that it had been reduced to this minimum.

13. The Appellant's accountant applied for the penalty to be suspended; this is a possibility allowed in certain circumstances. Mr Woodroff wrote a further letter on 26 May 2010 refusing that application. He gave as his reason for refusal that penalties for inaccuracies which are not likely to recur are not considered suitable for suspension as it is not possible to set conditions to encourage future compliance. Being able to set such conditions is a requirement if the penalty is to be suspended. There followed further correspondence between the Appellant's accountant and Mr Woodroff in which the Accountant sought to persuade Mr Woodroff to the contrary view but she failed to persuade him to suspend the penalty and on 26 July 2010 Mr Woodroff wrote saying he had arranged for the issue of a formal penalty notice.

14. Mr Woodroff's decision was reviewed at the request of the Appellant and the review was conducted by Mr Cranham who wrote with his review decision on 28 October 2010 . The normal time within which the review would normally have been concluded was extended at Mr Cranham's request so that he could fully consider the legislation and HMRC guidance which was new.

15. The review upheld Mr Woodroff's decision. Mr Cranham focused on two matters. First he considered whether the Appellant's behaviour was careless which (agreeing with Mr Woodroff) he concluded was the case and secondly he considered whether the penalty should be suspended which he concluded would not be appropriate on the basis it was not possible to identify specific conditions that would help Mr Hardy to avoid becoming liable to further careless inaccuracy penalties.

The Appellant made a further appeal to this Tribunal.

**Submissions**

16. For the Appellant Mr May made the following submissions. The Appellant was not careless. It was agreed that if the Appellant was not careless he was not liable for a penalty for the inaccuracy on his return. The meaning of careless for the purpose of the relevant penalty regime is defined as a failure to take reasonable care which HMRC submits can be likened to negligence described in the case of Blyth v Birmingham Waterworks Co (1856) as being "the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs would do or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence if,

unintentionally, they omitted to do what a prudent and reasonable man would have done, or did that which a person taking reasonable care would have done". Mr May without disagreeing with this interpretation submitted that the manner in which the payments had been made and the background to the agreement about them meant that the Appellant was not acting unreasonably when he omitted the payments from his return. Mrs Gardiner submitted that the Appellant was a sophisticated individual who had signed a compromise agreement and he should have taken some care about what should be included on his return for that period. This was not simply a mistake but was careless.

17. If the Appellant was careless Mr May acknowledged that, in principle, he is liable to a penalty since the return was inaccurate. The amount of the penalty and the question of the correct penalty level has to be considered properly and Mr May submitted that Mr Woodroff had apparently reached a decision concerning the Appellant's behaviour very quickly and with only limited facts and that his decision was unreasonable. On 20 May 2010 in his telephone conversation with the accountant he acknowledged he needed to consider the Appellant's behaviour but was already indicating what penalty reduction he might apply and he then formed an opinion about the Appellant's behaviour the next day when he wrote a detailed letter summarising his views and setting out the proposed penalty reduction. Further the letter he wrote that day was misleading since it failed to mention the relevance of special circumstances and implied that where carelessness was established there was an irreducible minimum penalty. In fact special circumstances can allow the penalty to be further reduced. Mr May considered that in this case there were special circumstances and they justified a reduction of the penalty to zero even if the Appellant was considered to be careless; it was clear that Mr Woodroff had not considered at all whether there were special circumstances.

18. Mr May also submitted that the decision not to suspend the penalty was flawed. The decision was reached so quickly that it could not have been considered properly and even if it had been the subject of proper consideration the reason given for rejecting the application was wrong since in fact the Appellant faced a similar situation the following year when he received a payment in connection with the termination of his subsequent employment so the October and December 2008 payments did not relate to a "one off" situation and a relevant condition for suspension could have been imposed. There was some difference between Mr Woodroff and Mr Cranham about what went wrong. Mr Woodroff (in deciding not to suspend the penalty) did not consider the Appellant's inaccurate return resulted from an inadequate record keeping system whereas Mr Cranham (in deciding there had been a careless inaccuracy) commented that HMRC expected him to make and preserve sufficient records for him to make a complete and accurate return. The Appellant could have been required to instruct his present accountant to audit his bank statements as part of the process of completing the return. This would allow the accountant to alert the Appellant to the need for certain receipts to be declared on the return if they would not have been otherwise picked up by the Appellant; if that procedure had been adopted for the return in question the October and December payments would have been brought to the attention of the accountant who would have asked the Appellant about them and discussed whether they needed to be included in his return. Mrs Gardiner submitted that there must be a link between the condition and the statutory objective which is to avoid the taxpayer becoming liable to further

penalties for careless inaccuracy and there would not be such a link if this condition was imposed.

**The Law**

19. The relevant law is to be found in Schedule 24 Finance Act 2007 and the penalty regime was first imposed on 6 April 2008 which is at the start of the year for which the Appellant made the tax return in question. All the following references to paragraphs are to paragraphs of Schedule 24 Finance Act 2007.

20. Paragraph 1 provides for a penalty in a number of circumstances which include where he makes a return under section 8 Taxes Management Act 1970 (a personal return) and it contains an inaccuracy which amounts to, or leads to, an understatement of a liability to tax and the inaccuracy was careless. It is agreed that the Appellant's personal return did contain an inaccuracy which amounted to, or led to, an understatement of tax. Paragraph 3 provides that for the purposes of a penalty under paragraph 1 an inaccuracy is "careless" if it is due to a failure by the taxpayer to take reasonable care.

21. Paragraph 4 provides that (in these circumstances) the standard penalty payable under paragraph 1 for careless action is 30% of the potential lost revenue which is itself defined. There is no dispute about the amount of potential lost revenue in this case.

22. Paragraph 10 provides for reductions in the standard penalty if there is prompted or unprompted disclosure; the amount of the reduction depends first upon whether the disclosure was prompted or unprompted and then depends upon the quality of the disclosure. It was not disputed that the Appellant made a prompted disclosure. In the case of a prompted disclosure the reduction under paragraph 10 may not cause the penalty to fall below 15% of the potential lost revenue. Mr Woodroff referred in his letter to this irreducible minimum when setting the penalty at 15%.

23. Paragraph 11 provides for a special reduction where there are special circumstances. It is expressly provided that special circumstances cannot include ability to pay or the fact that potential loss of revenue from one taxpayer is balanced by a potential over-payment by another and the reference to reducing a penalty includes a reference to staying a penalty and agreeing a compromise in relation to proceedings. Unlike the case of a paragraph 10 reduction there is no cap on the reduction that can be made under paragraph 11.

24. The provisions which allow a penalty to be suspended are to be found in paragraph 14. The suspension period may not exceed two years and must contain conditions for suspension to be complied with by the taxpayer and the penalty may only be suspended if compliance with a condition of suspension would help the taxpayer to avoid becoming liable to further penalties under paragraph 1. If the conditions have been complied with the suspended penalty is cancelled.

25. Paragraphs 15 16 and 17 contain provisions about appeals. A taxpayer may appeal against a decision that a penalty is payable, against the amount of the penalty, against the decision not to suspend and against the conditions of suspension. On an

appeal against a decision that a penalty is payable the tribunal may affirm or cancel HMRC's decision and on an appeal against the amount of the penalty the Tribunal may affirm HMRC's decision or substitute for that decision another decision that HMRC had power to make and in substituting its decision the Tribunal may rely on paragraph 11 to a different extent only if the Tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed. It may only order HMRC to suspend the penalty if it thinks HMRC's decision not to suspend was flawed.

**Our decision**

26. We consider that the Appellant was careless in omitting details of the October and December 2008 payments from his return and to that extent dismiss his appeal. In reaching this conclusion we took into account that he had signed a compromise agreement; although we did not see it there was no suggestion it failed to mention that the payments would be made and we conclude it is most unlikely they would not have been mentioned. The payments were substantial. The Appellant had an accountant. It is perhaps unfortunate that his accountant did not ask him whether he had received payments in connection with his redundancy but equally it is unfortunate that the Appellant did not tell her about the payments and ask for her advice whether or not to include them.

27. It is impossible for us to substitute another decision that HMRC had power to make under paragraph 10 unless we decided to increase the penalty since the maximum reduction for a prompted disclosure had already been given. However we believe that the decision was flawed because no account was taken of special circumstances and thus there was no consideration of a possible further reduction under paragraph 11. We think that HMRC's decision in respect of the application of paragraph 11 was flawed. In fact we do not consider HMRC thought about a paragraph 11 reduction at all but we consider it would be perverse if a decision in respect of its application can be flawed but a failure to think about it at all cannot be flawed. We think there were special circumstances that should have been taken into account including in particular that the Appellant was very shaken by the redundancy process and the prospect of facing litigation following the termination of his employment. In addition we could see that he was genuinely confused about his redundancy package and that he thought tax had been deducted at the appropriate rate before he was paid in the same way as his previous salary payments including bonus payments. We can see how he arrived at that conclusion and he was certainly not assisted by the failure of his employer to send him the necessary supporting documents when they paid him these further payments. We believe that all these are special circumstances for the purposes of paragraph 11 which should have been taken into account. We also think that the Appellant was misled by Mr Woodroff's letter into thinking that the penalty had been reduced to the maximum extent allowed by the legislation so that the only further option was for him to apply for the penalty to be suspended and so it is unsurprising that he did not alert Mr Woodroff fully to the circumstances surrounding the redundancy and the events that were current when he submitted his return. We decided to reduce the penalty to 2.5% of the potential loss of revenue in the light of these circumstances. We decided that it would not be appropriate to reduce the penalty to zero because the taxpayer might have discussed

the matter with his advisers; we can see that he was very confused about his position and with good reason but he was not entirely without fault.

28. Having reduced the penalty we considered whether the decision not to suspend the original penalty was flawed. We decided that this was not the case. We considered the submission that there was confusion between Mr Woodroff and Mr Cranham about what had led to the taxpayer's carelessness in that Mr Woodroff commented it did not result from an inadequate record keeping system whereas Mr Cranham commented the taxpayer should have kept sufficient records to allow his return to be completed accurately but these remarks were to some extent taken out of context and Mr Woodroff was using the record keeping example as a reason why no meaningful condition could be attached to a decision to suspend since the error related to an unusual situation unlikely to recur whereas Mr Cranham was simply saying that the Appellant should keep a clear account of his affairs so that he could make an accurate return which is obviously something everyone should do. We recognise that the Appellant did in fact receive a further payment in similar circumstances but it was clear that by that time he was alert to the need for it to be included in his return; it is evident that the investigation into the earlier return had prompted him to be careful and nothing further needed to be done to improve matters. It is possible that a "one off" situation might expose a more widespread deficiency in a taxpayers system of reporting but there was no evidence that this was the case here and we concluded that the decision not to suspend was not flawed and dismissed the appeal in relation to that issue.

29. 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.

**TRIBUNAL JUDGE**

**RELEASE DATE: 12 SEPTEMBER 2011**